CASES DECIDED
IN
THE UNITED STATES
COURT OF CLAIMS

SEPTEMBER 1, 1977 TO FEBRUARY 28, 1978

WITH

REPORT OF
DECISIONS OF THE SUPREME COURT
IN COURT OF CLAIMS CASES

REPORTED BY

AUDREY BERNHARDT

REPORTER

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JUDGES AND OFFICERS OF THE COURT

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Judges

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ROBERT L. KUNZIG
MARION T. BENNETT

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ROALD A. HOGENSON

Senior Judges

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WILSON COWEN

Trial Judges

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[1] Died October 29, 1977.
[2] Retired effective January 1, 1971 and recalled as a senior trial judge.
[3] Entered on duty November 7, 1977.
[4] Retired effective December 31, 1977 and Roger L. Nieman, Sr., entered on duty January 2, 1978.
[5] Retired effective December 31, 1977 and Frederick J. Neville entered on duty February 13, 1978.

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(Charged with the defense of the Government)
SEPTEMBER 1, 1977 to FEBRUARY 28, 1978

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M. CARR FERGUSON
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BARBARA A. BABCOCK
Civil Division

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[Submitted by Chief Commissioner to Congress pursuant to Alaska Native Claims Settlement Act, Pub. L. 92–203, 85 Stat. 688]

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131(c); Allen; Bolding; Carrasco; Coors; DeMauro Constr. Corp.; Erdwein; Hollingsworth; Lee; Pete; Shaposka; Sun Oil Co.
141(b); Fraass Surgical Mfg. Co.
147(b); Camel Mfg. Co.; Hageny; 147(c); Carrasco; Erdwein
149, 149(f), 150; Gosman
151; A & H Cleaners
166(c); Singer Co.

October 7, 1977

MEMORIAL TO RAYMOND M. HUDSON, JR.

Upon the convening of court this date, the court recognized Geoffrey Creyke, a member of the bar of the court, who called the court's attention to the recent death of Minor Hudson, a member of the bar of the court for many years, and presented the following statement in tribute to Mr. Hudson:

May it please the Court, I have the sad duty to suggest the death of my friend and partner, Minor Hudson, on September 2, 1977.

About 50 years ago, in a freshman chemistry class at George Washington University, my then newly found friend, Minor Hudson, facing an examination, and not having been totally attentive or always in attendance, borrowed my notes. The results of the examination were that he came out with a better grade than I did. This was my first realization of the extraordinary intellectual skills of this man. I thought then what I know now, that this man was to go far. As my friend ever since then, and my law partner for 42 years, that recognition has expanded and confirmed the existence of these very unusual gifts.

Combined with an extrovert personality, he demonstrated this unique capacity to relentlessly pursue, totally absorb, faithfully screen out and distill material facts, and relate them to the issues confronting him. Early on in his career he showed the ability to amaze judges, witnesses and adversaries in long trials by his rare ability to recall everything that anyone had said on any occasion and quote it verbatim. These qualities, combined with his own ability to investigate and pursue matters and his outstanding ability as a cross-examiner,

created what people are seeking to create with computers today; but he had these qualities plus the solid human judgment factors and other personality characteristics which made up the truly solid lawyer's lawyer. The same qualities have made better lawyers of the many who have worked with him.

He had many fine, indeed noble, characteristics but I would like to mention briefly three of them.

First, his *integrity*. It was absolutely total—to himself, his profession, to his partners, to the courts, to his clients and opponents. This is impossible to put into words, but anyone who ever knew Minor Hudson knew that this quality was there. It was a major part of the man.

Second, his unselfishness and kindness toward any and all was manifest in his personal and his professional life throughout his life.

Third, his personal magnetism, his charm, his humor, his ability as a pleader as well as a conversationalist, his imagination and vision, responsibility and understanding of issues rounded out this unique leader.

His intensity toward work and life was such that it has been said of him that he lived 132 years in the 66 he spent on this planet. He was a dedicated lawyer, a counsellor as well as an advocate, all his adult life except for four years in World War II when he was in the United States Navy serving with the Navy Civil Engineer Corps as aide to Admiral Ben Morrell. From these roots grew his expertise in Federal Construction law which he practiced exclusively here and abroad. He was active in missile sites, dams, airfields all over the world, the Inter American Highway and other projects. Major legal precedents in which he was involved were the neutralization of the old Rice Doctrine and the S&E case in the U.S. Supreme Court.

Minor Hudson died as he lived, in harness, having worked the day before his death, driven to his beloved Beverly farm in the Virginia Blue Ridge Mountains, spent a normal evening, retired and died in his sleep.

He shares the great respect and admiration of his eight surviving partners, a like number of associates, his family, and a legion of clients, friends, judges and colleagues in his profession. Carrying on his name are two fine sons and four grandchildren. In the hearts and minds of all of us, his was a great life.

Acting Chief Judge Davis responded on behalf of the court, thanking Mr. Creyke for his statement, recognized Mr. Hudson's service to this court and the bar, and directed that when the court adjourned this date it would do so in his memory.

DESIGNATION OF A SENIOR JUDGE OF THE UNITED STATES COURT OF CLAIMS FOR SERVICE IN ANOTHER CIRCUIT AND THE DISTRICT COURTS OF THAT CIRCUIT

The Chief Justice of the United States, the Honorable Warren E. Burger, pursuant to the authority vested in him by Title 28, United States Code, designated and assigned the Honorable Byron Skelton, Senior Judge of the United States Court of Claims, to perform judicial duties of circuit and district judge in the Fifth Circuit during the period September 1, 1977 and ending June 30, 1978, and for such further time as may be required to complete unfinished business.

DESIGNATION OF A JUDGE OF THE UNITED STATES COURT OF CLAIMS FOR SERVICE IN ANOTHER CIRCUIT

The Chief Justice of the United States, the Honorable Warren E. Burger, pursuant to the authority vested in him by Title 28, United States Code, designated and assigned the Honorable Robert L. Kunzig, a Judge of the United States Court of Claims, to act as a Circuit Judge of the United States Court of Appeals for the Seventh Circuit from September 19, 1977 to September 23, 1977, and for such additional time in advance thereof to prepare for the trial of cases, or thereafter as may be required to complete unfinished business.

DESIGNATION OF A SENIOR JUDGE OF THE UNITED STATES COURT OF CLAIMS FOR SERVICE IN ANOTHER CIRCUIT

The Chief Justice of the United States, the Honorable Warren E. Burger, pursuant to the authority vested in him by Title 28, United States Code, designated and assigned the Honorable Wilson Cowen, Senior Judge of the United States Court of Claims, to perform the duties of circuit judge in the Seventh Circuit during the period from

October 25, 1977 to October 28, 1977, and for such additional time in advance thereof to prepare for the trial of cases, or thereafter as may be required to complete unfinished business.

DESIGNATION OF A JUDGE OF THE UNITED STATES COURT OF CLAIMS FOR SERVICE IN ANOTHER CIRCUIT

The Chief Justice of the United States, the Honorable Warren E. Burger, pursuant to the authority vested in him by Title 28, United States Code, designated and assigned the Honorable Philip Nichols, Jr., a Judge of the United States Court of Claims, to act as a Circuit Judge of the United States Court of Appeals for the Seventh Circuit during the period beginning January 23, 1978 and ending January 27, 1978, and for such additional time in advance thereof to prepare for the trial of cases, or thereafter as may be required to complete unfinished business.

CASES DECIDED

IN

THE UNITED STATES COURT OF CLAIMS

SEPTEMBER 1, 1977 TO FEBRUARY 28, 1978, AND OTHER CASES NOT HERETOFORE PUBLISHED

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564 F.2d 38

THE PRAIRIE BAND OF THE POTTAWATOMIE TRIBE OF INDIANS, ET AL. v. THE UNITED STATES

Appeal No. 6-76
Ind. Cl. Comm. Docket Nos.
15-C, 29-A and 71
38 Ind. Cl. Comm. 128

[Decided October 19, 1977]

ON APPEAL AND CROSS-APPEAL FROM THE INDIAN CLAIMS COMMISSION

Indian claims; lands ceded under treaty; value of land; adequacy of consideration; commuted value of limited annuity payments as deduction; "payments on the claim"; 1974 amendment to 25 U.S.C. §70a; deduction for food, rations and provisions.—The Indian Claims Commission (ICC) determined that plaintiff-Indians ceded 5,220,868 acres of land, including about 1,000,000 acres of timberland, with a fair market value of $6,600,000—about $1.26 an acre—under the Treaty of September 26, 1833 and supplementary articles, and that the United States gave in exchange a total of only $2,360,800. The ICC held this consideration to be unconscionably small and found the United States liable for an additional $4,239,200; the ICC did not separately value the timberlands. Plaintiffs challenge a comment by the ICC in rejecting their expert's timberland valuation of $11 an acre "that much of the timber could be acquired without purchasing the land, even though the acquisition was illegal." The court *concludes* that although the United States had a special obligation to try to protect Indian timberlands, on this record it appears that the United States was powerless to protect either federally-owned areas or the Indian lands, and that plaintiffs have failed to show that the ICC decision permitted the Government to reduce the value of the ceded lands, in this proceeding, by reliance on its own wrong. Plaintiffs also claim that the limited annuity payments in issue should be valued at the commuted value and not the sum of the payments. The court *rejects* this contention

since this would be tantamount to charging interest, relying on *Pawnee Indian Tribe* v. *United States*, 157 Ct. Cl. 134, 301 F.2d 667 (1962). Plaintiffs also argue that the ICC should not have credited defendant for payments to chiefs, other individuals and creditors of the Tribe because these payments constituted bribes. The court *holds* that the payments were treaty-mandated and part of the exchange for the land cession. Defendant contends that the ICC erred in denying defendant a deduction for food, rations and provisions given to the Indians, and that the proviso of the 1974 amendment to 25 U.S.C. § 70a excepting food, rations and provisions expenditures from the amount defendant may claim as a deduction applies only to unilateral payments on the claim and does not apply to consideration payments. After reviewing the legislative history of the proviso, the court *affirms* the ruling of the ICC excluding from allowable offsets, under the 1974 amendments, $516,606.65 in "consideration payments" to the Indians. In all respects appealed from, the decision of the ICC is affirmed.

Indian claims; fiduciary obligation of Government to Indians; timberlands.

[1] Although the United States has a special obligation to try to prevent depredation of Indian timberlands, where the record indicates no reason to believe that the United States could have been expected to stop the cutting of the Indians' timber (although it was powerless to protect other federal areas), absent proof that the decision of the Indian Claims Commission permitted the Government to reduce the fair market value of the ceded lands because of its own wrong, it cannot be said that the Commission erred in setting the value it did.

United States ⚖105

Indian claims; land; consideration for treaty cessions; annuity, limited; commuted value as deduction for payment on claim.

[2] Where the treaty of cession provided for payment to be made over a stated period of years, the Government is entitled to be credited with the full amount of the annuities. To allow commutation down to present value would be tantamount to charging the United States with interest contrary to the established rule against allowance of interest in nonconstitutional cases, except where statute or contract provides. Respect for the existing precedent of *Pawnee Indian Tribe* v. *United States*, 157 Ct. Cl. 134, 301 F.2d 667 (1962), is counseled under the principle of *stare decisis*.

United States ⚖110, 118

Indian claims; land; consideration for treaty cessions; payments to Indian chiefs and creditors of Indians.

[3] Where a treaty of cession expressly made payments to Indian chiefs, other individual Indians and creditors of the Tribe, part of the consideration for the cession, such payments are considered part of the "payments made by the United States on the claim" subject to deduction from an award on the theory that the Tribe itself desired such payments to be made as part of the exchange for its land cession.

United States ⚖118

Indian claims; Indian Claims Commission; offsets; "payments on the claim".

[4] The proviso added to 25 U.S.C. § 70a by Pub. L. 93–494 (1974) "that expenditures for food, rations, or provisions shall not be deemed payments on the claim," was deliberately framed in general terms and was not confined to the Sioux's Black Hills claim.

United States ⚖118

Indian claims; Indian Claims Commission; offsets; "payments on the claim"; food, rations and provisions.

[5] Prior to the 1974 amendment to 25 U.S.C. § 70a "payment on the claim" was the normal statutory basis for the deduction of "consideration payments" as well as other types of payment relating to the claim on which suit was brought. Where the legislative history does not convince the court to depart from the normal interpretation of the phrase "that expenditures for food, rations, or provisions shall not be deemed payments on the claim," "payments on the claim" do not under the 1974 law cover past consideration expenditures for food, rations and provisions.

United States ⚖118

Statutes; construction and operation; judicial interpretation; generally.

[6] In the absence of some strong inference which may properly be drawn as to the intended scope of a piece of legislation from the type of information given to Congress during consideration of the proposed legislation, the reading of a statute should not be distorted by the courts simply because incorrect information was supplied.

Statutes ⚖217.2

Jack Joseph and *Robert C. Bell, Jr.*, attorneys of record in Dockets 71 and 29–A, for appellants-cross appellees. *Robert S. Johnson*, attorney of record in Docket 15–C. *Louis L. Rochmes*, of counsel.

A. Donald Mileur, with whom was *Assistant Attorney General Peter R. Taft*, for appellee-cross appellant. *John B. Carlson* and *Bernard M. Sisson*, of counsel

Rodney J. Edwards for The Minnesota Chippewa Tribe, et al., amici curiae.

Before COWEN and DURFEE, *Senior Judges*, DAVIS, NICHOLS, KUNZIG, and BENNETT, *Judges, en banc.*

DAVIS, *Judge*, delivered the opinion of the court:

In *Prairie Band of the Pottawatomie Tribe v. United States*, 28 Ind. Cl. Comm. 454 (1972), the Indian Claims

Commission (Ind. Cl. Comm.) held that the Pottawatomi Tribe or Nation ceded to the United States (under the Treaty of September 26, 1833, 7 Stat. 431, and the Articles Supplementary of September 27, 1833, 7 Stat. 442) its recognized title to Royce Area 187 in eastern Wisconsin and northeastern Illinois, a large part of Royce Area 160 in Wisconsin, and Royce Areas 188–190 in southwestern Michigan.[1] In the proceeding now under review the Commission determined the value of the ceded lands as well as the value of the consideration the Indians received from the Government, including all payments on the claim. The findings were that the Pottawatomis had ceded 5,220,868 acres with a fair market value of $6,600,000—about $1.26 per acre—[2] and that in exchange for these lands the United States gave a total of only $2,360,800 in return. Since the Commission held this consideration to be unconscionably small, the latter figure was offset against the former, and the United States found liable for $4,239,200. 38 Ind. Cl. Comm. 128, 229–30, 341–42 (1976). Both sides have appealed, each challenging selected aspects of the Commission's determination.

I

Plaintiffs' appeal

A. Plaintiff-appellants' first point concerns the valuation of the timbered property. Among the more-than-5 million acres ceded by plaintiffs there were about one million of timberlands. The Indians' expert valued these at $11 an acre, while the defendant's witness thought them worth only $.35. The Commission did not value the timberland separately; its determination of $1.26 per acre covered all the ceded land.[3] But it is quite clear both that the Ind. Cl.

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[1] The references are, of course, to Royce's maps in the 18th Annual Report of the Bureau of American Ethnology (Part 2), Indian Land Cessions (1896–97).

In 28 Ind. Cl. Comm. 454, 469, the Commission also held that the plaintiffs in Dockets No. 15–C (Prairie Band of the Pottawatomie Tribe of Indians, et al.), No. 29–A (Hannahville Indian Community, et al.) and No. 71 (Citizen Band of Pottawatomi Indians) could sue in a representative capacity for and on behalf of the Pottawatomi Tribe or Nation.

[2] The valuation date was February 21, 1835. 28 Ind. Cl. Comm. at 497.

[3] This method of evaluating the property as a whole, not appraising the various

Comm. affirmatively took account of the timber as adding value, and that it considered the timbered acres to be worth more than the $1.26 average. In summing up its holding on valuation of the ceded territory, the opinion below declared that "about a million acres were in the timber-pinery region of northeastern Wisconsin, most of which were potentially valuable for commercial lumber development," 38 Ind. Cl. Comm. at 187, and in rejecting the defense estimate it said that "the defendant's failure to find any enhancement of the pinery lands by reason of the potential value of the timber resulted in substantially underestimating the value of these lands." 38 Ind. Cl. Comm. at 182. The Commission also referred expressly in some detail to the growing market for timber "with the growth and development of the midwestern portions of the country." 38 Ind. Cl. Comm. at 142–43, 182–83, 250, 252–53. It likewise observed that the timber resources of the ceded areas were an example of a feature which contributed particularly to the value of parts of the tracts and made those portions "much more valuable than $1.25 an acre, the price at which they were sold by the United States." 38 Ind. Cl. Comm. at 186. It is plain, therefore, that timber value was affirmatively taken into account as a substantial element.

Nevertheless, plaintiffs challenge a glancing comment the Commission made in rejecting the Indian expert's high timberland valuation of $11 an acre—a remark which recalled that at that time loggers entered public lands to cut down trees, either in flagrant trespass or under logging permits which the War Department issued without statutory authority.[4] From this the Pottawatomis infer that the

value components separately and then adding them, was appropriate and is not challenged. *See, e.g., Citizen Band of Potawatomi Indians v. United States*, 179 Ct. Cl. 473, 491, 391 F.2d 614, 624 (1967), *cert. denied*, 389 U.S. 1046, 390 U.S. 957 (1968).

[4] The statement plaintiffs attack was as follows: "Considering the risks involved in the lumber industry, *and considering that much of the timber could be acquired without purchasing the land, even though the acquisition was illegal*, it seems doubtful that a purchaser who wanted to acquire the timber as well as the land would pay almost nine times as much for the pinery lands as the $1.25 for which the United States offered to sell it" (emphasis added). 38 Ind. Cl. Comm. at 181–82. Elsewhere in its opinion and findings, the Commission referred descriptively to such logging operations on plaintiffs' land by trespassers and by loggers who had received unauthorized permits from the War Department. 38 Ind. Cl. Comm. at 144, 171, 250–51.

Commission improperly reduced the value of the Indians' pine tracts because the Federal Government wrongly permitted outsiders to remove the Indians' timber (before the cession) without paying compensation. We think that appellants read far too much into this brief and somewhat cryptic remark of the Commission. It was offered as only one of several reasons why $11 per acre was excessive, not as a ground for choosing the over-all figure of $1.26 per acre or for disregarding the worth of the timberlands. As we have pointed out, the Commission plainly thought that, whatever depredations there may have been, the timberlands did have superior value and it gave credit for that factor. Moreover, the Ind. Cl. Comm's words about outsiders acquiring timber "without purchasing the land, even though the acquisition was illegal" could well have referred only to logging trespassers who commonly carried out their illegal actions on public lands generally, not Indian lands alone.[5] If so, it is hard to say that the Commission had to blind itself completely to a common fact-of-life in that era, not confined to native territory. Though the United States had a special obligation to try to protect Indian timber, *Oneida Tribe v. United States*, 165 Ct. Cl. 487, *cert. denied*, 379 U.S. 946 (1964), it was severely hobbled in several ways during that period, *see* 165 Ct. Cl. at 496–500, and on this record there is no reason to believe that it could be expected to stop the cutting of the plaintiffs' lumber although it was powerless to protect other federal areas.

Our conclusion on plaintiffs' first point is that they have failed to show that the decision below permitted the Government to reduce the value of the ceded lands—in this proceeding—by reliance on its own wrong.

B. As part of the consideration for the cession, the United States agreed to pay the Pottawatomis $280,000 in annuities of $14,000 per year for 20 years. 7 Stat. at 432. The Commission's ruling deducted the full $280,000 even

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[5] The Commission may even have been referring to trespass depredations after the Indian lands passed into federal ownership, not while the Indians owned it. Conversely, the opinion may not have had in mind the grant by the War Department, without statutory authority, of logging permits on Indian tracts. It is difficult to decipher precisely what the short comment was intended to cover.

though the payments were strung out over two decades. 38 Ind. Cl. Comm. at 218–19. Plaintiffs contended below, and argue here, that only the commuted value of the $280,000 payment on the valuation date (*i.e.* $174,508) should have been offset against the value of the cession. They rely upon *Miami Tribe v. United States*, 150 Ct. Cl. 725, 281 F.2d 202, *cert. denied*, 366 U.S. 924 (1961), and *Crow Tribe* v. *United States*, 151 Ct. Cl. 281, 284 F.2d 361, *cert. denied*, 366 U.S. 924 (1961). *See also United States v. Absentee Shawnee Tribe*, 151 Ct. Cl. 700 (1960), *cert. denied*, 366 U.S. 924 (1961) (per curiam order). The Commission, however, followed the later decision in *Pawnee Indian Tribe v. United States*, 157 Ct. Cl. 134, 301 F.2d 667 (1962), *cert. denied*, 370 U.S. 918 (1962), which overruled *Miami Tribe*, *Crow Tribe*, and *Absentee Shawnees* on this very point, and held that the full face value of the annuities should be deducted as consideration. *Pawnee Indian Tribe* held that allowing commutation down to present value would be tantamount to charging the United States with interest, contrary to the established rule.

Although the Indian appellants ask us to abandon *Pawnee Indian Tribe* and revive *Miami Tribe* and *Crow Tribe*, we are not willing to do so. Litigation under the Indian Claims Commission Act is coming to its close. *Pawnee* has been the law for 15 years[6] and in all probability has been relied upon in other adjudications and settlements. The canon against allowance of interest in nonconstitutional cases (except where statute or contract provides)—on which the court relied in *Pawnee*—has been strengthened over the years not weakened, for Indian cases as well as others. *See, e.g., United States v. Mescalero Apache Tribe*, 207 Ct. Cl. 369, 378 ff., 518 F.2d 1309, 1314 ff. (1975), *cert. denied*, 425 U.S. 911 (1976). There is, we think, insufficient ground in this instance for rejecting the counsel of *stare decisis*. *Cf. Mississippi River Fuel Corp.* v. *United States*, 161 Ct. Cl. 237, 246–47, 314 F.2d 953, 958 (1963) (Davis, J., concurring).

C. The last of plaintiffs' claims on appeal is that the Commission erred in crediting the Government, as part of

[6] *Miami Tribe* reigned for less than two years.

the consideration for the land cession, with treaty-mandated payments to Pottawatomi chiefs, other individual Indians, and creditors of the tribe. The 1833 treaty and its supplementary articles, 7 Stat. at 431–33, 442–43, called for annuities to a number of Indian chiefs, a fund for individual Indians whose requests for reservations had been denied, and a fund to satisfy creditors of the Indians. It is said that these payments were either in the nature of bribes or were non-tribal payments which should not have been deducted from the value of the ceded territory in this tribal proceeding. The Commission rejected these arguments. 38 Ind. Cl. Comm. at 217–218, 220.

We cannot say that this ruling was wrong. The treaty (including the supplementary articles) expressly made these payments part of the consideration for the cession (and therefore part of the "payments made by the United States on the claim," to be deducted from the award under Section 2 of the Claims Commission Act, 25 U.S.C. § 70a). *See* Part II, *infra*. Similar payments to individual Indians, required by a treaty in consideration for a cession or other undertaking by an Indian group, have been held deductible as consideration. *See Quapaw Tribe v. United States*, 1 Ind. Cl. Comm. 644, 665–66 (1951), *aff'd on this point*, 128 Ct. Cl. 45, 55 (1954). The theory is that the tribe itself desired such payments to be made as part of the exchange for its land cession. Plaintiffs insist that these payments were really in the nature of bribes to obtain the treaty, but at best the evidence to that effect is miniscule; clearly the Commission did not have to draw such an inference.

As for the payment of the tribe's debts, the Commission had earlier held, on the same principle, that a treaty provision of this type constituted part of the consideration for a cession. *Absentee Delaware Tribe v. United States*, 9 Ind. Cl. Comm. 346, 357 (1961). The opinion below correctly found that result peculiarly appropriate here "where the Senate, in consenting to the ratification of the Treaty, required the examination by a commissioner of all debts for which payment was sought under the provision to pay

debts of the Indians in order to exclude any found to be unjust." 38 Ind. Cl. Comm. at 218.[7]

II

Defendant's cross-appeal

A more serious issue comes to us on the Government's cross-appeal. We noted in Part I, C, *supra*, that Section 2 of the Indian Claims Commission Act, 25 U.S.C. § 70a, provides that "[i]n determining the quantum of relief the Commission shall make appropriate deductions for all payments made by the United States on the claim * * *."[8] By Act of Oct. 27, 1974, PUB. L. No. 93–494, 88 Stat. 1499, (codified at 25 U.S.C. § 70a (1970)), Congress added the proviso "That expenditures for food, rations, or provisions shall not be deemed payments on the claim." In this case the Commission found that, under the 1833 treaty and supplementary articles, the United States spent $516,606.65 (as part of the consideration for the cession) for food, rations, and provisions which the 1974 law made non-deductible from the grand total of the "payments on the claim." In its appeal defendant urges that the Ind. Cl. Comm. misconstrued the 1974 Act to include the consideration promised and given under the treaty by the United States. That amendment, the Government argues, is limited to payments unilaterally made by the United States after a claim is brought forward, apart from any consideration paid (for a cession or undertaking by the Indians) under a treaty or agreement. Defendant's position is, therefore, that the $516,606.65 for food, rations, and

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[7] The Senate reservation provided (7 Stat. 447–48, Note) that debtors were to be paid only the sums found by the commissioner to be justly due them, "in no instance increasing the sum agreed to be paid." 7 Stat. 447, Note. Any monies saved by deduction or disallowance of the debts were to be paid to the Indians.

[8] The same section also calls for mandatory deduction "for all other offsets, counterclaims, and demands that would be allowable in a suit brought" by an Indian group in this court. In addition, the Commission has discretionary authority ("if it finds that the nature of the claim and the entire course of dealings and accounts between the United States and the claimant warrants such action") to offset gratuitous expenditures by the Federal Government—except that Congress has specified certain types of gratuities which shall not be offset at all.

provisions should have been included in the deductions from the award, along with the other sums offset.[9]

It has become an axiom in interpreting legislation that it is well to start with the words of the statute though one may not stop there. Here, if one puts aside the legislative history and background of the 1974 proviso, the normal, spontaneous reading of "payments on the claim" would cover consideration (if paid) for a land transfer embodied in a treaty of cession. If such consideration paid by the United States was less than the value of the property, it would ordinarily be thought of as a partial "payment on the claim," to be taken into account in calculating the final award.[10] Over all the twenty-odd years prior to the 1974 amendment, the Commission regularly deducted treaty-prescribed consideration (if paid) from its award of the value of ceded land (or other property) to the extent the award was more than the consideration—and that seems to have been done under the original provision for mandatory deduction "for all payments made by the United States on the claim," since there is and was no separate provision for offset of "consideration."[11] "Payment on the claim" was, it

[9] Defendant does not contend in this court that the $516,606.65 figure covered more than "food, rations, or provisions." The issue here centers solely on the meaning of "payments on the claim" in the 1974 proviso.

Before the Commission the parties did not litigate the coverage of that proviso. Plaintiffs argued that the more-than-half-million dollar sum was non-deductible regardless of the proviso (that contention is still preserved in this court), and the defendant responded to that position. The Commission *sua sponte* imported the 1974 amendment into the case, holding it applicable. The opinion said (38 Ind. Cl. Comm. at 224): "Although there is some ambiguity in the language of the amendment and its legislative history as to whether 'payments on the claim' are to be deemed synonymous with or include 'consideration,' our present judgment as to the intent of Congress is that such forms of payment are not to be credited against our awards whether or not there exists a refined distinction between consideration and payments on the claim."

[10] Before the Indian Claims Commission Act was passed, the Supreme Court said: "Payment upon a claim means payment on account or in part as distinguished from one made and accepted as payment in full." *Klamath and Moadoc Tribes v. United States*, 296 U.S. 244, 251 (1935).

[11] For example, defendant itself cites in its reply brief, at 7–8, among a number of other Commission cases, the 1961 decision in *Cheyenne-Arapaho Tribes v. United States*, 10 Ind. Cl. Comm. 1, 37–61, in which the Commission deducted from its award a substantial sum in food, rations, or provisions as part of the Government's "consideration" for the Indians' undertakings.

In this very case, defendant, in the findings it proposed to the Ind. Cl. Comm. on the award, included the now challenged $517,000 (approx.) under its Proposed Finding No. 19, headed "Payments on the Claim"; it reserved the term "Considera-

is plain to us, the normal statutory basis for the deduction of "consideration payments," as well as other types of payment relating to the claim on which suit was brought.[12]

Thus, the problem emerges not from the language of the 1974 proviso, but from its legislative history. The most significant portion of this is the August 1974 Hearing before the House Subcommittee on Indian Affairs.[13] Several strains run through this hearing, some of which tend to support the Commission's reading below while others incline toward the defendant's current construction.

The undeniable impetus for the 1974 amendment was the Commission's decision on the so-called Sioux "Black Hills" claim. *See Sioux Nation v. United States*, 33 Ind. Cl. Comm. 151 (1974), *rev'd in part*, 207 Ct. Cl. 234, 518 F.2d 1298, *cert. denied*, 423 U.S. 1016 (1975). There the

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tion" for the Government's undertakings in the treaty, regardless of whether or not those undertakings were actually executed. Thus, the expenditures in fact made for food, rations, and provisions were characterized by defendant itself as "payments on the claim," at a time when the coverage of the 1974 proviso was not being litigated.

[12] Defendant now suggests that the deduction of paid consideration could be justified separately under the statutory provision in 25 U.S.C. § 70a for deduction of "all *other* offsets, counterclaims, and demands that would be allowable in a suit" brought by the Indian group in this court under Title 28 (emphasis added). There are at least three objections to this proposal. The first is that this provision, rather than to be taken independently of "payments on the claim," throws light on the latter clause by suggesting that consideration-payments, one sort of legal offsets normally allowable in this court, are incorporated in "payments on the claim." The second difficulty is that this particular provision, if read separately, seems never previously to have been invoked alone, in this context, by the Ind. Cl. Comm. or the defendant. The third objection is the doubt that the cited provision, if taken separately, was intended to apply to offsets integrally related to a non-legal Indian claim which could *not* be brought in this court under Title 28—such as revision of a treaty for "unconscionable consideration" or a claim "based upon fair and honorable dealings that are not recognized by any rule of law or equity." The present case falls in that "non-legal" category.

[13] *Amendments to the Indian Claims Commission Act: Hearings on H.R.16170 Before the Subcomm. on Indian Affairs of the House Comm. on Interior & Insular Affairs*, 93rd Cong., 2d Sess. (1974) [hereinafter cited as *Hearings on* H.R. 16170.] It is unnecessary to set out in detail all the steps in the passage of Public Law 93–494, a measure mainly devoted to authorizing appropriations for the Indian Claims Commission, but also containing the new proviso to § 2 of the Claims Commission Act. Because of that statute's peculiar legislative course (spelled out in H.R. REP. No. 93–1446, 93rd Cong., 2d Sess. 3, *reprinted in* [1974] U.S. CODE CONG. & AD. NEWS 6118 (Conference Rep.)), there is very little formal history bearing on the proviso other than the *Hearings on* H.R. 16170. The other bits of relevant legislative history appear in S. REP. No. 93–863, 93rd Cong., 2d Sess. 1, *reprinted in* [1974] U.S. CODE CONG. AD. NEWS 6112–6115; H.R. REP. No. 93–1446, *supra*; and 120 CONG. REC. (1974).

Commission held that an 1877 Act had unilaterally acquired (by eminent domain and, if not, as a result of less than fair and honorable dealings[14]) the Black Hills portion of the Sioux reservation, and also that the United States was entitled to offset as "payments on the claim" all expenditures on behalf of the Sioux made by the United States in fulfillment of the obligations assumed under the 1877 Act—including very substantial sums for food, rations and provisions. The Sioux felt that this offset holding could wipe out, or at least seriously erode, the award they would receive under the Commission's holding on liability. They sought legislation which would prevent this conclusion[15] and the 1974 amendment ultimately resulted. In one formulation, the issue in this court is how far, if at all, did Congress go beyond the Black Hills case itself.

There is some hint that the 1974 proviso should be strictly confined to the Sioux's Black Hills claim and that claim alone, but this reading is clearly not permissible. The amendment was deliberately framed in general terms,[16] and it was retained in that general form even though there were pointed proposals at the House hearings that the Sioux problem could and should be handled by a special bill covering only that particular claim, rather than by an amendment applicable also to others. The representative of the Interior Department specifically said that the amendment would apply to pending claims other than those of the Sioux, *Hearings on* H.R. 16170, *supra* note 13, at 15, and opposed selecting the Sioux for special treatment "if there are others that have a valid claim of this sort," *Hearings on* H.R. 16170, *supra* note 13, at 17. *See Hearings on* H.R. 16170, *supra* note 13, at 16–17, 25, 27, 42. We think, therefore, that it would simply rewrite the 1974 statute to turn it into a private Act for the Sioux alone.

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[14] This court on review held that any eminent domain claim was barred by an earlier decision of the Court of Claims. *United States* v. *Sioux Nation*, 207 Ct. Cl. 234, 247–49, 518 F.2D 1298, 1305–06, *cert. denied*, 423 U.S. 1016 (1975). The court was not asked to, and did not, disturb the holding as to fair and honorable dealings.

[15] *See* S. REP. No. 93–863, *supra* note 13, at 1–5, for the Sioux' initial proposal to Congress.

[16] The Sioux memorandum proposing it, *see* note 15, *supra*, says that it is "couched in general terms," although its objective was to help the Sioux.

It is then said that, in any event, the amendment should be applied only to cases just like the Sioux's Black Hills claim. In its decision in that case, 33 Ind. Cl. Comm. at 219, the Commission declared that the 1877 acquisition-by-statute of the Black Hills by the Federal Government was unilateral and not pursuant to any valid treaty or agreement; this meant, the opinion said, that whatever the Sioux received for this land was not "consideration" (which, in the Commission's view, requires a contractual relationship) but simply "payments on the claim." The defendant now takes this as a ruling that "payments on the claim" (in the statutory sense) and "consideration" are mutually exclusive, the former referring solely to unilateral, unbargained for payments by the United States. Though there is no support for this position in the Commission's decisions (*see supra* and *infra*), there is some help for it in *Hearings on* H.R. 16170, *supra* note 13. The written statement filed by Chairman Kuykendall of the Commission, *Hearings on* H.R. 16170, *supra* note 13, at 44–45, seems to draw this distinction, and to say that the proposed bill would not affect the deduction of bargained for "consideration."[17] The same theme was echoed, though less clearly,

[17] In pertinent part, this statement said:

"• • • we must analyze three types of payments made by the United States to the Indian tribal claimant and for which the Government may obtain credit or have deducted from a monetary award to such claimant. They are known as (1) consideration, (2) payments on the claim and (3) gratuitous or gratuitous offsets.

"The first one, "consideration," is not truly an offset. In the typical land cession case the United States paid something in money, lieu lands, or goods, for the ceded land in accordance with the treaty or agreement it had made with the Indian tribe. The Commission tests the conscionability of the transaction by comparing the then fair market value of the land with the amount of consideration paid. If the transaction is determined to be unconscionable because the treaty consideration is so grossly less than the value of the ceded land, the Indian claimant is entitled to an award of the difference between the two sums, but the consideration paid by the United States is credited against the gross fair market value to determine the net award to the plaintiff tribe. It is inherent in a conscionability claim that credit will be given for the consideration paid in order to reach a fair result. *It is our understanding that there is no proposal before the Congress to change the existing practice of crediting consideration paid* [emphasis added].

"Payments on the claim" are those sums, goods and services provided to the tribe by the United States in response to a claim or grievance asserted by the tribe. As distinguished from consideration, payments on the claim are made unilaterally by the United States not because of any treaty obligation to do so, but in acknowledgment by the Government that some compensation is due the tribe for past specific cases. Such payments are usually authorized by statute. Like consideration, but unlike gratuities, Sec. 2 of our Act as it stands, requires that

by the chairman of the subcommittee, *Hearings on* H.R. 16170, *supra* note 13, at 16, 24, 25, but the Justice Department representative (who opposed the bill) told the Congressman flatly there was no relevant difference between consideration and payments on the claim, *Hearings on* H.R. 16170, *supra* note 13, at 24, that "[l]egally, there is no distinction between these two," and that "they are both deducted from the award on the same terms," *Hearings on* H.R. 16170, *supra* note 13, at 25. At the hearings the Justice position clearly was that food, rations, and provisions given as treaty consideration would be covered by the proposed proviso. *See Hearings on* H.R. 16170, *supra* note 13, at 18, 20, 25. The Interior Department (which favored the legislation) also seems to have had the same understanding. *Hearings on* H.R. 16170, *supra* note 13, at 1–2, 11.

Reversing its position, the Department of Justice now relies on the distinction apparently drawn in Chairman Kuykendall's written statement, and bolsters its present view by the fact that the Commission told the subcommittee that, if the proposed "food, rations, or provisions" proviso had been in the Claims Commission Act from the beginning it would have barred only about $100,000 in deductions up to 1974 and, aside from the Sioux claim, would have only "minimal" or "insignificant" effect in the future. *See Hearings on* H.R. 16170, *supra* note 13, at 15, 17, 24, 29, 31, 38, 45, 47–48. Defendant says that unless "consideration" payments are excluded—as it now urges—it would be impossible to come up with the small figure of $100,000 for pre-1974 effect, or use the characterization "minimal" or "insignificant" for future impact. That appears to be true for the past; $100,000 would be far too small if "payments on the claim" covered past consideration expenditures for food, rations, and provisions, as well as purely unilateral payments for the same purpose. With respect to future effect, the use of "minimal" is more arguable; in the light of the Sioux payments for food,

payments on the claim be deducted from any award to the Indian tribal claimant. Payments on the claim have appeared rather rarely in Indian claim litigation, and usually have consisted of money or land given to a tribal claimant rather than food or provisions. * * *"

rations, and provisions, estimated to be from $30,000,000 to $57,000,000, *see Hearings on* H.R. 16170, *supra* note 13 at 19, 36, 39, the present challenged deduction of some $517,000 plus the others we now know about could be said to be "minimal" or "insignificant" on a comparative scale.[18]

This legislative history is certainly ambiguous, as the Commission noted below, 38 Ind. Cl. Comm. at 224, and we have concluded that, everything considered, the Commission was correct in refusing to separate out and exclude "consideration" payments of food, rations, and provisions from the coverage of the 1974 proviso. The normal understanding of the language would cover both, as we have pointed out, and to overcome such a normal reading the showing from legislative history or legislative purpose must be persuasive. *See National Labor Relations Board v. Plasterers' Union,* 404 U.S. 116, 129 n.24 (1971); *United States v. Dickerson,* 310 U.S. 554, 562 (1940); *United States v. American Trucking Ass'ns,* 310 U.S. 534, 543–44 (1940). We do not find such persuasiveness here. The distinction drawn at the hearings by the Commission chairman between "consideration payments" and "payments on the claim" had not previously appeared in the Commission's decisions,[19] and though it seems to have been accepted at the hearing by the House subcommittee's chairman there is little or no indication that it was adopted by the other

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[18] The H.R. REP. No. 93–1446, *supra* note 13, at 3, refers to the fact that the House of Representatives had originally been unwilling to agree to the "food, rations, or provisions" amendment without holding a hearing, "inasmuch as the cost of such an amendment to the Indian Claims Commission Act could approach $100 million." If the figure of "$100 million" relates to the amount thought to be involved in the Sioux case, the level of "minimal" for other cases would obviously be higher on a comparative basis; if, however, "$100 million" refers significantly to other cases (as well as the Sioux's) it likewise shows that "minimal" was probably not used in the absolute sense of trivial or very small.

[19] The *Sioux* decision, *supra,* 33 Ind. Cl. Comm. at 219, and the other opinions cited by defendant *(Prairie Band of Pottawatomie Tribe v. United States,* 33 Ind. Cl. Comm. 394, 404 (1974); *Nez Perce Tribe v. United States,* 24 Ind. Cl. Comm. 429, 433–34 (1971)), merely pointed out that "consideration" required a consensual element; they did not hold or suggest that "consideration payments" could not also be "payments on the claim," or that the two terms were mutually exclusive.

It is worth noting that the chairman of the Commission, who filed the written statement with the House subcommittee, joined in the opinion below which we are asked by the Government to reverse with respect to the 1974 proviso.

members of the subcommittee or that it was communicated in any understandable fashion to the full House committee, to the conference committee, or to the membership of the full House and Senate. The distinction was not accepted or pushed, while the bill was going through the Congress, by either of the two executive departments most interested in Indian affairs (Justice and Interior), one of which opposed the measure while the other supported it.

Moreover, there seems to be only the weakest of policy reasons for differentiating, insofar as food, rations and provisions are concerned, between so-called consensual "consideration payments" and non-gratuitous unilateral payments by the Federal Government. If humanitarian impulses preclude the Government from collecting from the Indians for feeding and sustaining them when such expenditures are made by the United States, on its own, sometime after a cession of the Indian tract previously used for sustenance, then it would seem most peculiar to treat differently with sustenance payments promised in the same treaty which transfers the land to the Government. It is said in support of the distinction that in the case of "consideration payments" there would at least be participation and bargaining by the Indians for the food, rations, or provisions, but that supposed difference pales into nonexistence in the many cases in which any "bargaining" was decidedly one-sided—such as a case (like this) under Section 2(3) of the Claims Commission Act, 25 U.S.C. § 70a, where a treaty is being revised for "unconscionable consideration," or where fraud, duress, or mistake is involved, or where there is a claim under Section 2(5) based on less than fair and honorable dealings.

The biggest obstacle, in the legislative history, to accepting the normal meaning of the language of the 1974 amendment is the repeated belief, expressed at the House subcommittee hearings, that the amendment would have cost the Government, aside from the *Sioux* case, only $100,000 in the past (and would have only "minimal" impact for the future). The $100,000 figure is clearly too small if the broader reading is adopted but might well be correct if one accepts the sharp distinction between

"consideration payments" and other "payments on the claim."[20] But there is little or no indication that anyone in Congress, aside perhaps from the chairman of the subcommittee, understood the presumed basis of this monetary estimate, and therefore there is little ground for inferring that Congress as a whole desired the narrow reading. In other words, while it is obvious that Congress thought that (aside from the *Sioux* case) the 1974 proviso would not cost too much, there is no good reason to think that Congress understood that the figures supplied to it excluded "consideration payments." Congress as a whole may very well have thought that "consideration payments" for sustenance plus other comparable "payments on the claim" would not amount to much *in toto*. In the absence of some strong inference which may properly be drawn as to the intended scope of a piece of legislation from the type of information given to Congress, the reading of a statute should not be distorted by the courts simply because incorrect information was supplied. If Congress feels that it was misled or misinformed as to cost or other factors, it can change the legislation.

Because, for these reasons, the legislative history does not convince us to depart from the normal interpretation of the words of the 1974 proviso, we accept that reading as correct and affirm the Commission's ruling which excluded from allowable offsets, under the 1974 amendment, some $516,606.65 in "consideration payments" to the Indians for food, rations, and provisions.[21]

In all respects appealed from, the decision of the Indian Claims Commission is *Affirmed*.

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[20] We have already said that "minimal" is too comparative a word for us to tell whether or not it was an improper forecast. *See* text and note at note 18 *supra*. At one point in the hearings, *Hearings on* H.R. 16170, *supra* note 13, at 23, the chairman of the subcommittee indicated that it would probably be "less than $2 million in the future." From what we now know, we cannot say that that is a wholly illusory prognosis of the total future cost of the 1974 amendment as we now construe it.

[21] We need not, and do not, pass upon the other grounds put forward by the Indians for affirming the Commission's action deducting the $517,000—apart from the 1974 proviso. *See* note 9, *supra* (second paragraph).

NICHOLS, *Judge*, concurring:

I join in Judge Davis' opinion and in the judgment of the court. As to the cross-appeal, I would like to say that I would find the issue even more difficult than it is, but for a factor not mentioned in the opinion. Congress was clearly concerned as to the bogging down of the Sioux case or cases in factual investigation of minutiae of insufficient importance to justify the time lost and the auditors' pay. The Senate Committee said, 3 U.S. Code Congressional and Administrative News (1974) 6111, 6115, that the computation of an offset for feeding the Sioux, if allowed, would "take 5 - 15 men working at least a year (and probably longer) - - - and even then the absence of necessary data may prevent the preparation of a complete and fully accurate report." This of course relates to the Sioux cases and not others, but the Committee plainly indulged in the presumption that the problems manifest in the Sioux cases might arise in others. It declined to enact special legislation for the Sioux alone. In effect, the problems of their cases were taken as models of others about which no information was obtained, except for generalizations that may have been mistaken. As Judge Davis says, we cannot correct Congress' factual errors. If the figure of almost $25,000,000, or more, estimated as the cost of feeding the Sioux, was significantly less in the cases of other Indian tribes but still substantial, the cost of accurate computation of the offset would be disproportionate to the amount involved and would delay final settlement to no useful purpose. It is not reasonable to believe that Congress, striking this blow for simplicity and speed of adjudication, would have wished to restrict its effect to instances duplicating the Sioux situation, for the cost of the computation and delay it caused would be disproportionate to the benefit of making it, whether the rations were furnished as "consideration," as "payments on the claims," or even as "gratuities." Thus the view originally put forward by Chairman Kuykendall, but later abandoned by him, would have almost entirely frustrated an object Congress sought to achieve. The computations in the instant case have been made, apparently, but there is

nothing to show Congress meant this to make a difference, though clearly it was thinking primarily of instances when they had not.

In *United States* v. *Delaware Tribe of Indians*, 192 Ct. Cl. 385, 427 F.2d 1218 (1970) we had before us a Commission rule that it would ignore for offset purposes any gratuities in the nature of subsistence, etc., which in any year did not exceed five percent of the deficiency in the compensation previously paid the Indians for their lands, below what it should have been. We struck this down as an attempt to award interest, contrary to the applicable precedents. However, the parties made it clear that the Commission was also attempting to shed some of the burden of making insignificant calculations. There was much talk about the cost of a hypothetical sack of peanuts, as against the cost of tracking it down for audit purposes a century later. This we recognized as worthy of consideration, even though the cure adopted was incurably tainted. Congress has now acted in the premises and we should give its enactment all the effect the language permits.

OCTAVIO CARRASCO, JR., ET AL. v. THE UNITED STATES

[No. 190–76. Decided October 19, 1977]*

ON DEFENDANT'S AND PLAINTIFFS' MOTIONS FOR SUMMARY JUDGMENT

Civilian pay; temporary overseas employees; Foreign Tax Assistance Staff; GS-grade and salary upon return to Internal Revenue Service.—Plaintiffs are present or former Internal Revenue Service employees who accepted temporary overseas assignments with the Foreign Tax Assistance Staff (FTAS) of the Agency for International Development. They claim that upon expiration of their FTAS assignments they were returned to IRS at an unlawfully low GS-grade and step contrary to Internal Revenue Manual §183(10).9(2). After plaintiffs' return to IRS, after this court's decision in *Whelan* v. *United States*, 208 Ct. Cl. 688, 529 F. 2d 1000 (1976), and after the present action was filed, the IRS Director of the Personnel Division issued a memorandum purporting to invoke the exception in the last sentence of said section

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* See the court's order of February 3, 1978 on the parties' motions for rehearing, *post* at 1044.

Syllabus

with respect to claims by FTAS and other returnees to higher GS-grade positions than their former, same or comparable GS-grade positions. Defendant contends that the exception was taken in the best interests of the agency, particularly in view of its assertion that the *Whelan* decision overturned 13 years of consistent administrative practice. Defendant also argues that the claims are barred by laches, premised on plaintiffs' delays in filing this action. It is *held* (1) that the said memorandum was of no effect in relation to these plaintiffs because it was not timely issued; (2) that although plaintiffs delayed in commencing suit the prejudice to defendant appears minimal and falls short of the degree required to warrant application of laches, since here there is no duplication of salary or administrative disruption; (3) that under the circumstances the court is not mandating retroactive promotions under the guise of a slotting process — utilization of § 183(10).9(2) as the means of reconciling two separate classification systems was properly construed in *Whelan* as a slotting process; (4) that since plaintiffs Carrasco, Gonzales (for his second tour) and Osburn have been compensated at "a salary appropriate to the salary" each was earning with FTAS, the petition is dismissed as to them; and (5) since plaintiffs Caso, Gonzales (for his third tour), Lugo, Mangerich and Martin suffered salary decreases as did Whelan, they are entitled to recover appropriate back pay and allowances. The amount of recovery for these plaintiffs will be determined pursuant to Rule 131(c), and as to them, the Secretary of the Treasury is directed to correct their records pursuant to Rule 147(c).

Pleading and practice; summary judgment; when appropriate.

[1] Where no general issues as to any material facts exist, disposition of the case by summary judgment is appropriate under Rule 101(d).

Federal Courts ⚖1120

Civilian pay; overseas employees; Foreign Tax Assistance Staff; reemployment rights and salaries of returning employees.

[2] The exception clause of § 183(10).9(2) of the Internal Revenue Manual was not intended as an escape hatch through which the Government could effectively defeat at any time prior to final judicial resolution reasonable claims, by employees returning to the Service after satisfactorily completing an overseas tour of at least 1 year, to salaries comparable to those of the highest FC grades held by them for one year.

Internal Revenue ⚖1221

Civilian pay; laches; prejudice, necessity for showing.

[3] Since laches is an equitable doctrine, there is no automatic formula to apply, and each case must be determined in light of its own particular facts. The two essential elements that must be present before this court will bar a claim through laches are an unreasonable delay by plaintiff in prosecuting the claim and resulting prejudice to defendant, although the longer the delay, the less the need for defendant to show specific prejudice.

Federal Courts ⚖1104

Syllabus

Civilian pay; promotions; Foreign Tax Assistance Staff.

[4] A promotion of an IRS employee temporarily assigned overseas with the Foreign Tax Assistance Staff does not automatically and of itself imply an equivalent promotion with the IRS upon his return since two separate classification systems are involved. The language of § 183(10).9(2) of the Internal Revenue Manual and the circumstances surrounding its adoption indicate that one of its primary purposes was to reconcile promotion problems concerning transfer of employees between these separate systems. The IRS's choice of doing this by means of comparing salaries is reasonable.

Internal Revenue ⇐1221

Civilian pay; promotions; Court of Claims jurisdiction.

[5] This court is not to entangle itself in the promotion process concerning Government employees.

Federal Courts ⇐1079

Civilian pay; overseas employees; Foreign Tax Assistance Staff; reemployment rights and salaries of returning employees.

[6] Reconciliation of two nonidentical classification systems, manifested in § 183(10).9(2) of the Internal Revenue Manual concerning the salary of a returning IRS employee from a Foreign Tax Assistance Staff assignment who has satisfactorily completed his tour, is best viewed as being essentially a slotting process (*see Whelan* v. *United States*, 208 Ct. Cl. 688, 529 F. 2d 1000 (1976)), as opposed to an intrusion by the court into the promotion business.

Federal Courts ⇐1079

Civilian pay; overseas employees; Foreign Tax Assistance Staff; reemployment rights and salaries of returning employees.

[7] Sec. 183(10).9(2) of the Internal Revenue Manual providing that a returning employee "will have new GS salaries established on the basis of the salary of the highest FC grade held for one year" refers to grade only, not to grade and step. Thus, the IRS is required to compensate such an employee with a salary appropriate to the salary he was earning with the Foreign Tax Assistance Staff, and cannot reduce his final FTAS salary, even though giving the employee a salary equal to or greater than his final FTAS salary may entail slotting him in a higher GS-grade than that from which he commenced his FTAS assignment.

Internal Revenue ⇐1221

Civilian pay; overseas employees; Foreign Tax Assistance Staff; reemployment rights and salaries of returning employees.

[8] Viewing § 183(10).9(2) in the context of what it intended to accomplish, the regulation does not obligate IRS to place a returning FTAS employee in a higher GS-grade when a salary equal to or greater than his final FTAS salary is available through utilization of a lower grade at a higher step, assuming that the grade at which the employee is slotted upon return is not lower than the GS-grade held prior to the FTAS assignment.

Internal Revenue ⇐1221

John I. Heise, Jr., attorney of record, for plaintiff. *Barbara A. Miller*, of counsel.

Richard J. Webber, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DURFEE, *Senior Judge*, DAVIS and KASHIWA, *Judges*.

DURFEE, *Senior Judge*, delivered the opinion of the court:

In this civilian pay case, plaintiffs are seven present or former Internal Revenue Service (IRS) employees who accepted temporary overseas assignments with the Foreign Tax Assistance Staff (FTAS) of the Agency for International Development (AID). This case is a sequel to *Whelan* v. *United States*, 208 Ct. Cl. 688, 529 F.2d 1000 (1976).

Plaintiffs contend that, upon expiration of their FTAS assignments, they each were returned to the IRS at an unlawfully low General Schedule (GS) grade and step. Plaintiffs premise their argument upon Internal Revenue Manual (IRM) § 183(10).9(2),[1] which provides:

> Upon termination of assignments to FTAS, employees returning to the General Schedule (GS), who have satisfactorily completed overseas tours of at least one year, will have new GS salaries established on the basis of the salary of the highest FC grade held for one year. Should an employee's current FC salary fall between two GS step rates, the employee will be given the higher GS step. The new GS salary of an employee who did not satisfactorily complete an overseas tour of at least one year, will be set at the grade and step at which it would be had the employee not received an assignment with FTAS. Exceptions to the preceding salary-setting rules may be authorized by the Director, Personnel Division, when the best interests of the Service are involved.

Since the instant case is so intertwined with the decision in *Whelan*, we will discuss, in some detail, the facts and holding of that case. *Whelan* involved an employee who, upon his return to the IRS from an overseas assignment with FTAS, was assigned to a GS–14, step 10 position at an

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[1] MT 1800–92 (1–5–68). IRM § 183(10).9(2) was superseded by IRM § 0352.3, effective 1975.

annual salary lower than the salary he was receiving prior to the expiration of his FTAS assignment. Whelan maintained that, under IRM § 183(10).9(2) (the same regulation as involved in the instant case), he was entitled to a GS–15, step 8 position, which would not result in a salary decrease. Defendant argued that reversion to Whelan's former GS–14 grade (or a comparable position) was a condition of his assignment with FTAS. After finding that Whelan had effectively occupied the same FTAS grade for more than one year, the court rejected defendant's argument by stating:

> We hold that no such condition existed and such is not required by the language of the Foreign Service Act. The pertinent IRS regulation, Section 183(10).9(2), which is cited above, provides quite differently by *assuring* the employee that his new GS salary shall be "established on the basis of the salary of the highest FC grade held for one year."
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> * * * * *
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> We find that the GS–14, step 10 slot assigned to plaintiff did *not* compensate him * * * with "a salary *appropriate to the salary* he was earning with FTAS" since it resulted in a reduction in pay of $2,432 per annum. Nor did it meet the more specific standard of the agency's own regulations providing for a new GS salary "established on the basis of the salary of the highest FC grade held for one year." [Emphasis in original.] [208 Ct. Cl. at 693–94, 529 F.2d at 1002–03.]

Defendant in the instant case seeks to distinguish the *Whelan* decision on two principal grounds: *first*, that the Director of the Personnel Division of IRS, subsequent to *Whelan*, has invoked an exception to IRM § 183(10).9(2), as authorized by the last sentence of that regulation; *second*, that plaintiffs' claims are barred by the doctrine of laches. Alternatively, defendant contends that the *Whelan* decision is incorrect and should be overruled. No genuine issues of material fact exist, and disposal by summary judgment is appropriate under Rule 101(d).

Since the factual circumstances surrounding each plaintiff's claim are not identical, we reproduce the relevant chronology with regard to each plaintiff:

Carrasco (one tour):[2]

— GS–13/1 with IRS prior to FTAS assignment.
— 1/30/66: commenced FTAS assignment at FC–5/3.
— 1/1/67: promoted to FC–4/1.
— 7/13/69: FC schedule change pursuant to AID Notice No. 73; grade and step converted from FC–4/3 to FC–3/1.
— 6/28/70: expiration of FTAS assignment at FC–3/2, $21,584; return to IRS at GS–13/10, $21,791 (increase of $207).
— time delay from return to IRS until filing suit: 5 years, 11 months.
— relief sought: back pay to compensate for the loss of subsequent within-grade step increases occasioned by being slotted at GS–13/10 (the grade ceiling), rather than GS–14/4, upon return to IRS.[3]

Caso (two tours):[4]

Tour #2:

— GS–11/10 with IRS prior to FTAS assignment.
— 11/16/69: commenced FTAS assignment at FC–4/1.
— 1/10/71: FC schedule change pursuant to Pub. L. No. 91–656; grade and step converted from FC–4/3 to FC–10/3.
— 7/2/72: expiration of FTAS assignment at FC–10/4, $20,612; return to IRS at GS–11/10, $17,305 (decrease of $3,307).
— the lowest GS grade and step to which an FC–10/4 could have been transferred without loss of pay on 7/2/72 was GS–12/10 at $20,627.
— time delay from return to IRS until filing suit: 3 years, 10 months.
— relief sought: back pay representing the difference receivable if slotted at GS–13/4, rather than GS–11/10, upon return to IRS, including loss of any subsequent within-grade step increases.

Gonzales (three tours):

Tour #2:

— GS–14/7 with IRS prior to FTAS assignment.

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[2] Within-grade and quality step increases are omitted. Plaintiffs Caso, Gonzales, and Martin each served more than one FTAS tour. The facts concerning only those tours directly at issue are repeated here. These statistics are provided for background information. They are not intended to constitute findings binding on the trial judge for purposes of any future Rule 131(c) proceedings.

[3] All plaintiffs also seek appropriate correction of records and retirement credits.

[4] We interpret plaintiff Caso's petition as seeking relief only for his second FTAS tour. This interpretation is based on several factors including the six-year statute of limitations, his subsequent FTAS tour, and his affidavit.

— 8/31/69: commenced FTAS assignment at FC–3/6.
— 1/10/71: FC schedule change pursuant to Pub. L. No. 91–656; grade and step converted from FC–3/7 to FC–12/4.
— 10/31/71: expiration of FTAS assignment at FC–12/4, $26,563; return to IRS at GS–14/10, $27,061 (increase of $498).
— time delay from return to IRS until filing suit: 4 years, 6 months.
— relief sought: back salary and back retirement pay to compensate for being slotted at GS–14/10, rather than GS–15/4, upon return to IRS.

Gonzales:

Tour #3:

— GS–14/10 with IRS prior to FTAS assignment.
— 7/9/72: commenced FTAS assignment at FC–12/5.
— 1/20/74: expiration of FTAS assignment at FC–12/6, $32,680; return to IRS at GS–14/10, $31,519 (decrease of $1,161).
— the lowest GS grade and step to which an FC–12/6 could have been transferred without loss of pay on 1/20/74 was GS–15/6 at $32,973.
— time delay from return to IRS until filing suit: 2 years, 4 months.
— relief sought: back salary and back retirement pay to compensate for being slotted at GS–14/10, rather than GS–15/6, upon return to IRS.

Lugo (one tour):

— GS–11/3 with IRS prior to FTAS assignment.
— 11/28/65: commenced FTAS assignment at FC–7/6.
— 7/30/67: promoted to FC–6/3.
— 7/13/69: FC schedule change, pursuant to AID Notice No. 73; grade and step converted from FC–6/4 to FC–5/5.
— 5/17/70: expiration of FTAS assignment at FC–5/6, $15,888; return to IRS at GS–11/10, $15,478 (decrease of $410).
— the lowest GS grade and step to which an FC–5/6 could have been transferred without a loss of pay on 5/17/70 was GS–12/5 at $16,084.
— time delay from return to IRS until filing suit: 5 years, 11+ months.
— relief sought: back pay representing the difference receivable if slotted at GS–12/5, rather than GS–11/10 (the grade ceiling), upon return to IRS, including loss of any subsequent within-grade step increases.

Mangerich (one tour):

— GS–14/2 with IRS prior to FTAS assignment.
— 6/12/66: commenced FTAS assignment at FC–4/4.
— 12/5/66: promoted to FC–3/1.
— 6/30/68: promoted to FC–2/1.
— 7/13/69: FC schedule change pursuant to AID Notice No. 73; grade and step remained at FC–2/2.
— 8/24/70: expiration of FTAS assignment at FC–2/3, $28,116; return to IRS at GS–14/10, $25,538 (decrease of $2,578).
— the lowest GS grade and step to which an FC–2/3 could have been transferred without a loss of pay on 8/24/70 was GS–15/8 at $28,226.
— time delay from return to IRS until filing suit: 5 years, 9 months.
— relief sought: back salary and back retirement pay to compensate for being slotted at GS–14/10, rather than GS–15/8, upon return to IRS.

Martin (two tours):

Tour #2:

— GS–15/10 with IRS prior to FTAS assignment.
— 9/8/68: commenced FTAS assignment at FC–3/10.
— 7/13/69: FC schedule change pursuant to AID Notice No. 73; grade and step converted from FC–3/10 to FC–2/6.
— 10/18/70: expiration of FTAS assignment at FC–2/7, $31,632; return to IRS at GS–15/10, $29,752 (decrease of $1,880).
— the lowest GS grade and step to which an FC–2/7 could have been transferred without a loss of pay on 10/18/70 was GS–16/7 at $31,857.
— time delay from return to IRS until filing suit: 5 years, 7 months.
— relief sought: back salary and back retirement pay to compensate for being slotted at GS–15/10, rather than GS–16/7, upon return to IRS.

Osburn (one tour):

— GS–14/8 with IRS prior to FTAS assignment.
— 1/21/68: commenced FTAS assignment at FC–4/9.
— 7/13/69: FC schedule change pursuant to AID Notice No. 73; grade and step converted from FC–4/9 to FC–3/7.
— 7/12/70: termination of FTAS assignment at FC–3/7, $25,064; return to IRS at GS–14/10, $25,538 (increase of $474).
— time delay from return to IRS until filing suit: 5 years, 10 months.
— relief sought: back pay to compensate for the loss of subsequent within-grade step increases occasioned by

being slotted at GS–14/10 (the grade ceiling), rather than GS–15/4, upon return to IRS.

I.

The Exception to IRM § 183(10).9(2)

The final sentence of IRM § 183(10).9(2) states that "[e]xceptions to the preceding salary-setting rules may be authorized by the Director, Personnel Division, when the best interests of the Service are involved." The court in *Whelan* specifically noted that defendant did not make such a claim of exception. 208 Ct. Cl. at 692, 529 F.2d at 1002. On August 17, 1976, *after* plaintiffs had terminated their assignments with FTAS and returned to IRS, *after* this court's decision in *Whelan*, and *after* plaintiffs had filed suit in the instant case, the Director of the Personnel Division for IRS issued a memorandum purporting to "except any claims, to any higher GS-grade positions than their former, 'same or comparable' GS-grade positions, by FTAS/TAAS overseas returnees, from the provisions of former IRM 183(10).9(2)."

Defendant contends that the exception was taken in the best interests of the agency, particularly in view of its assertion that the *Whelan* decision overturned thirteen years of consistent administrative practice. As to the question of why the exception was not taken earlier, defendant argues that the IRS could not have foreseen the need to invoke the exception until the *Whelan* decision overturned its past administrative practice and that, if plaintiffs had timely asserted their claims, the exception would almost certainly have been authorized in an equally timely manner. The memorandum of the Director claiming to invoke the exception maintains that the *Whelan* decision may require IRS to grant noncompetitive promotions in violation not only of existing collective bargaining agreements and merit promotion plans, but also of laws and regulations applicable to Civil Service positions. The memorandum further states the position that IRS never intended for an employee returning from an FTAS assignment to be granted any higher GS-grade position

than the former GS-grade position held prior to commencement of the FTAS assignment.

We are not persuaded by defendant's argument. To permit IRS to invoke the exception clause *after* plaintiffs returned to IRS from their FTAS assignments, *after* the decision in *Whelan*, and *after* suit had been filed in the instant case would essentially render IRM § 183(10).9(2) meaningless. Such an exception clause, predicated on "the best interests of the Service", was not intended as an escape hatch through which defendant could effectively defeat reasonable claims by plaintiffs at any stage of proceedings prior to final judicial resolution of such claims.

IRM § 183(10).9(2) was obviously intended to provide an incentive or assurances for IRS employees to accept temporary overseas assignments with FTAS. What defendant overlooks is the fact that plaintiffs had completed their end of the arrangement. Upon termination of their FTAS assignments and return to IRS, plaintiffs became entitled to the benefit of the regulation. We hold that the Director's August 17, 1976 memorandum purporting to invoke the exception clause of IRM § 183(10).9(2) was of no effect in relation to plaintiffs because it was not timely issued.

II.

Laches

Defendant argues that plaintiffs' claims should be barred by laches. This argument is premised on the fact that plaintiffs Carrasco, Lugo, Mangerich, Martin, and Osburn each returned from his FTAS tour at issue over 5½ years prior to the filing of the petition; plaintiff Caso waited over 3½ years; and plaintiff Gonzales delayed over 4½ years and 2 years, respectively, after completion of his second and third FTAS tours.[5]

Defendant maintains that prejudice to the Government exists in that, if plaintiffs are entitled to recover, they will be promoted to positions which have already been filled by

[5] Defendant also contends that the initial FTAS assignments of plaintiffs Caso, Gonzales, and Martin, although not at issue in this case, are relevant for purposes of laches in that they make even more unreasonable plaintiffs' delay in filing suit.

promotion of others. By way of example, if a plaintiff were slotted at a GS–13 position upon return to IRS, and the court then determines that he should have been slotted at a GS–14 position, defendant contends that a duplication of salary would exist in the differential between the two salary rates because the agency would be paying the salaries of two GS–14 positions, rather than of one GS–14 and one GS–13. Defendant also contends that additional prejudice to the Government exists in the form of administrative disruption, in that recovery for plaintiffs would entail promotions which would conflict with collective bargaining agreements and merit promotion requirements.

We do not feel that plaintiffs' claims should be barred by laches. Since laches is an equitable doctrine, there is no automatic formula to apply. Each case must be determined in light of its own particular facts. The two essential elements that must be present before this court will bar a claim through laches are an unreasonable delay by plaintiff in prosecuting the claim and resulting prejudice to defendant. *Wilmot* v. *United States*, 205 Ct. Cl. 666, 684–85 (1974); *Albright* v. *United States*, 161 Ct. Cl. 356, 362–63 (1963). The longer the delay, the less the need, on the part of defendant, to show specific prejudice. *Gersten* v. *United States*, 176 Ct. Cl. 633, 636, 364 F.2d 850, 852 (1966).

Admittedly, plaintiffs did wait substantial periods of time from the termination of their FTAS assignments before commencing suit. However, despite this delay, the prejudice to defendant appears minimal and falls short of the degree required to warrant laches under the facts of this case. The most significant example of prejudice to the Government in civilian pay cases is the duplication of salary situation, where an illegally discharged employee is given back pay and his replacement has also been drawing the salary of the position. *Wilmot* v. *United States*, *supra*, 205 Ct. Cl. at 685.

No such duplication of salary is present here. Defendant's argument that plaintiffs, if entitled to recover, will be promoted to positions already occupied by others with resulting prejudice to the Government would not normally seem to have the serious financial and administrative

consequences which attend a total duplication of salary. Moreover, we fail to see evidence of any serious administrative disruption in regard to defendant's claims concerning conflict with collective bargaining agreements and merit promotion requirements. To properly slot returning FTAS employees in accordance with appropriate regulations should aid, not disrupt, the administrative process.

III.

Effect of Whelan *v.* United States

Defendant's alternative argument is that *Whelan* v. *United States*, 208 Ct. Cl. 688, 529 F.2d 1000 (1976) should be overruled.[6] We are of the opinion that *Whelan* was correctly decided, and that its precedent should control the instant case.

Defendant contends that the *Whelan* decision was legally in error for the following reasons: either the court erroneously concluded that the case involved a slotting process when, in fact, the court was ordering Whelan's promotion or the court wrongfully interpreted IRM § 183(10).9(2) as a mandatory promotion regulation. Defendant further maintains that the *Whelan* court apparently chose the former alternative because it determined that "[t]he claim here involves simply a slotting process". 208 Ct. Cl. at 695, 529 F.2d at 1003–04. Defendant viewed the court's action as retroactively promoting Whelan from one position to a different, higher grade position. Concomitantly, defendant argues that promotion with FTAS does not imply equivalent promotion with IRS since FTAS positions are excepted positions which can be filled without regard to Civil Service Commission (CSC) competitive registers. Thus, defendant argues, it cannot be said that because an individual may receive an FTAS promotion, this promotion automatically carries over to a permanent GS position with IRS.

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[6] Defendant also requests that, if this three-judge panel will not overrule a recent decision (*i.e.*, *Whelan*) by another panel of this court, our panel recommend to the full court that the instant case be considered en banc. We deny this request. It should be noted that defendant did not seek review by the Supreme Court of the *Whelan* decision.

We agree with defendant that the *Whelan* court viewed that case as essentially involving a slotting process. We also agree that a given promotion with FTAS does not automatically and of itself imply an equivalent promotion with IRS since they entail two separate classification systems. However, it is evident from the language of IRM § 183(10).9(2) and the circumstances surrounding its adoption that one of its primary purposes was to reconcile such problems concerning the transfer of employees between these separate systems. The regulation also resolves the administrative dilemma resulting from the possibility that persons called upon to serve FTAS assignments may, on the basis of meritorious service, receive promotions or pay increases with FTAS, yet simultaneously be deprived of the opportunity for corresponding promotions or increases with respect to their IRS positions. As a practical matter, IRS undoubtedly was of the opinion that it would be more difficult to recruit FTAS volunteers if they would not be able to retain the benefits of salary increases earned with FTAS upon return to IRS. Recognizing the potential difficulties in reconciling the two classification systems, the IRS's choice of so doing by means of comparing salaries is reasonable.

We are well aware of the principle that this court is not to entangle itself in the promotion process concerning Government employees. *Crowley* v. *United States*, 208 Ct. Cl. 415, 431, 527 F.2d 1176, 1184–85 (1975). In situations such as *Whelan* and the instant case, there exists a fine line by which to differentiate whether the claim involves a slotting process or whether the court is essentially usurping agency discretion and ordering a promotion. However, this line is not erased by a proper application of the *Whelan* rationale despite the fact that an employee may thereby be slotted at a higher GS grade than the one held prior to commencement of his FTAS assignment. No discretion as to promotions or other functions reserved for the agency are thereby vested in the court. Under the particular circumstances present, the reconciliation of the two nonidentical classification systems by IRM § 183(10).9(2) is best viewed as being essentially in the nature of a slotting process, as opposed to an intrusion by the court

into the promotion business. This situation is properly analogous to this court's decisions in *Kellerman* v. *United States*, 205 Ct. Cl. 484, 490, 504 F.2d 1128, 1132 (1974); *Jarett* v. *United States*, 195 Ct. Cl. 320, 329, 451 F.2d 623, 628 (1971); and *Nordstrom* v. *United States*, 177 Ct. Cl. 818, 825–26 (1966).

Consequently, the court is not mandating retroactive promotions under the guise of a slotting process. Utilization of IRM § 183(10).9(2) as the means of reconciling the two separate classification systems was properly construed in *Whelan* as a slotting process.

The only task remaining is to apply IRM § 183(10).9(2) to each plaintiff's particular circumstances. The regulation provides that returning FTAS employees, having satisfactorily completed a minimum one-year tour, "will have new GS salaries established on the basis of the salary of the highest FC grade held for one year." As Judge Bennett correctly points out in his concurring opinion in *Whelan*, this language refers to grade only, not to grade and step. 208 Ct. Cl. at 695–96, 529 F.2d at 1004. The second sentence of the regulation discusses the appropriate step to which the returning employee is entitled.

The essence of the *Whelan* interpretation of IRM § 183(10).9(2) is that IRS is required to compensate the returning employee "with 'a salary *appropriate to the salary* he was earning with FTAS' ". [Emphasis in original.] 208 Ct. Cl. at 694, 529 F.2d at 1003. Assuming that an employee held his highest FC grade for at least one year (as all plaintiffs here did with respect to the tours at issue), defendant cannot, consistent with this regulation, reduce his final FTAS salary upon return to IRS. This is true even though giving the employee a salary equal to or greater than his final FTAS salary may entail slotting him in a higher GS grade than that from which he commenced his FTAS assignment.

Unlike Whelan, plaintiffs Carrasco, Gonzales (for his second tour only), and Osburn did not have their salaries reduced upon return to IRS. However, they contend that they were wrongfully slotted at the highest step of a lower GS grade, rather than at a lower step of the next higher grade. Being slotted in this way, they lost the opportunity

for subsequent within-grade step increases for which they would have been eligible if slotted at a lower step of the higher grade.

We do not interpret IRM § 183(10).9(2) and *Whelan* in a way that obligates IRS to place a returning FTAS employee in a higher GS grade when a salary equal to or greater than his final FTAS salary is available through utilization of a lower grade at a higher step. This assumes, of course, that the grade at which the employee is slotted upon return is not lower than the GS grade held prior to the FTAS assignment. The regulation does not explicitly take into account the fact that an FTAS salary could be translated to an equivalent GS salary at different steps of different grades. However, by viewing the regulation in the context of what it intended to accomplish, defendant need only compensate a plaintiff "with 'a salary *appropriate to the salary* he was earning with FTAS' ". [Emphasis in original.] *Whelan, supra*, 208 Ct. Cl. at 694, 529 F.2d at 1003. Consequently, the claims of plaintiffs Carrasco, Gonzales (for his second tour only), and Osburn must be dismissed.

On the other hand, since plaintiffs Caso (for the tour at issue only), Gonzales (for his third tour only), Lugo, Mangerich, and Martin (for the tour at issue only) suffered salary decreases upon return in the same manner that Whelan did, they are entitled to recover appropriate back pay and allowances. Such recovery should reflect the differential between the GS grade and step at which they were improperly slotted and the lowest GS grade and step at which they should have been slotted without a loss of pay upon return to IRS.

CONCLUSION

The parties' respective cross-motions for summary judgment are granted in part and denied in part in accordance with this opinion. The amount of recovery for plaintiffs entitled to recover will be determined pursuant to Rule 131(c). The court directs the Secretary of the Treasury to

correct the records of those plaintiffs entitled to recover in accordance with this opinion pursuant to Rule 147(c).

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563 F.2d 1013

BERT C. SHAPOSKA v. THE UNITED STATES

[No. 220–75. Decided October 19, 1977]

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

Civilian pay; classified Civil Service; appointment and tenure; career-conditional appointment v. noncompetitive temporary limited appointment; physically handicapped applicant.—Plaintiff, a deaf-mute, was hired on May 8, 1972 by the National Archives and Records Service of GSA through a temporary appointment not to exceed one year. He had been employed by the Federal Government in career-conditional status within 3 years prior to the Archives hiring, and was on an appropriate Civil Service appointment register. Defendant maintains that it had intended making plaintiff's hiring a temporary limited appointment not to exceed 700 hours (ch. 316, subch. 4–7, Federal Personnel Manual); however, defendant did not change plaintiff's status by September 6, 1972 when the initial 700 hours expired. On November 26, 1972 defendant purported to convert by reinstatement plaintiff's appointment to career-conditional status (5 C.F.R. § 315.401). The reinstatement was concurred in by the CSC Appeals Examining Office, which held that the effective date of conversion was September 6, 1972. Plaintiff claims that his termination on August 1, 1973 was unlawful for three reasons: *first*, the termination was in violation of his procedural rights under 5 U.S.C. § 7501; *second*, the termination was due to discrimination against him due to his physical handicap; *third*, the termination was in retaliation for a letter he wrote to his Congressman complaining of his job situation. Since defendant considered plaintiff to be in a probationary status, the notice of separation stated that plaintiff's appeal rights were limited to the grounds specified in 5 C.F.R. § 315.806. The CSC Appeals Examining Office held that plaintiff was still in his probationary period when terminated because the agency had authority to appoint plaintiff to a temporary limited appointment not to exceed 700 hours at the time he was hired. It is *held* that plaintiff's hiring on May 8, 1972 placed him in career-conditional status as of that date, that his one-year probationary period had expired before his termination, that he was in competitive status at the time of termination, that he was accordingly entitled to the procedural safeguards of 5 U.S.C. § 7501 which were denied him, and that the adverse action against him is void, entitling him to back pay, less appropriate offsets, from the date of his termination. The case

is remanded to the trial division for determination of the amount of recovery due plaintiff and whether or not reinstatement should be ordered under the circumstances of this case.

Civilian pay; classified Civil Service; conditional appointment.

[1] A person appointed to a career-conditional position must normally serve a one-year probationary period before competitive status is acquired, and during that period he is entitled only to the notice of dismissal provisions of 5 C.F.R. § 315.804 and to appeals to the Civil Service Commission within the limitations of 5 C.F.R. § 315.806.

United States ⚖36

Civilian pay; appointment and tenure; career-conditional appointment v. noncompetitive temporary limited appointment; physically handicapped applicants.

[2] There is nothing in the Civil Service Commission Regulations or the Federal Personnel Manual that mandates that all severely handicapped persons must be hired through the special limited appointment procedure of the Federal Personnel Manual, ch. 316, subch. 4–7.

United States ⚖36

Civilian pay; appointment and tenure; temporary limited appointment; physically handicapped applicant.

[3] Where a Government agency hires a physically handicapped person and chooses to restrict that appointment to a temporary limited appointment not to exceed 700 hours, the agency must make the restricted nature of the appointment clear in the hiring process. Absent such specification, a presumption exists that the handicapped person is entitled to the same appointment status that a non-handicapped person would receive.

United States ⚖36

Civilian pay; adverse personnel action; procedural violation.

[4] Where it is found that an adverse personnel action has been carried out in substantial violation of procedural regulation, it is a void action and the employee is entitled to recover any pay of which he has been illegally deprived.

United States ⚖39(8)

Sheldon I. Cohen, attorney of record, for plaintiff.

Gerald L. Schrader, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DURFEE, *Senior Judge*, NICHOLS and BENNETT, *Judges*.

DURFEE, *Senior Judge*, delivered the opinion of the court:

This civilian pay case involves the dismissal of a physically handicapped person from his job as a GS–7

Editor with the National Archives and Records Service of the General Services Administration (GSA). Plaintiff seeks to overturn the decision of the Civil Service Commission (CSC) which upheld his termination. Plaintiff's argument is premised on three principal grounds: *first,* plaintiff's procedural rights under 5 U.S.C. § 7501 (1970)[1] were violated since he was in competitive status at the time of his termination, and he was afforded only those termination procedures due a person serving a probationary period; *second,* plaintiff was terminated as a result of discrimination against him due to his physical handicap; *third,* the catalyst for plaintiff's termination was a letter he wrote to Congressman Frank M. Clark concerning alleged injustices against plaintiff at his job. For the reasons set forth below, we grant plaintiff's cross-motion for summary judgment.

Plaintiff, a deaf-mute, was hired by the Archives on May 8, 1972. Plaintiff had been employed by the Government in career-conditional status within three years prior to his hiring by the Archives, although such employment had ended some time before he was offered the position with the Archives. Prior to his hiring by the Archives, plaintiff was on an appropriate Civil Service appointment register.

The CSC Form 50 (Notification of Personnel Action) recorded plaintiff's hiring by the Archives as a temporary appointment not to exceed one year, and cited 5 C.F.R. § 316.402(b)(1) (1972)[2] as the authority for such an appoint-

[1] 5 U.S.C. § 7501 (1970) provides, in relevant part:

(a) An individual in the competitive service may be removed or suspended without pay only for such cause as will promote the efficiency of the service.

(b) An individual in the competitive service whose removal or suspension without pay is sought is entitled to reasons in writing and to—

(1) notice of the action sought and of any charges preferred against him;

(2) a copy of the charges;

(3) a reasonable time for filing a written answer to the charges, with affidavits; and

(4) a written decision on the answer at the earliest practicable date.

* * * * *

[2] 5 C.F.R. § 316.402 (1972) (as amended March 1, 1972) provides, in relevant part: Authorities for temporary appointments.

(a) *General rule.* An agency may make and extend a temporary limited appointment only with specific authorization from the Commission, except under the conditions published by the Commission in the Federal Personnel Manual or as provided in paragraph (b) of this section.

(b) *Noncompetitive temporary limited appointments.*

An agency may give a temporary limited appointment, without regard to the

ment. Defendant concedes that such an appointment was an error because it did not fall under any of the categories for temporary limited appointment listed in the Federal Personnel Manual (FPM) ch. 316, subch. 4–1(a).[3] Defendant maintains that it had intended to make plaintiff's hiring a temporary limited appointment not to exceed 700 hours. This latter-type appointment can be utilized by defendant to hire severely handicapped persons under the authority of FPM ch. 316, subch. 4–7, which provides, in relevant part:

4–7. Temporary Limited Appointments Outside Registers

* * * * *

existence of an appropriate register, to:

(1) A person with eligibility for reinstatement;

(2) A person eligible for career or career-conditional appointment under § 315.601 of this chapter;

(3) A person who meets the requirements for indefinite appointment under § 316.501;

(4) A former temporary employee of the agency who was originally appointed from a register, subject to the conditions published by the Commission in the Federal Personnel Manual; and

(5) A person eligible for career or career-conditional appointment under § 315.605 of this chapter.

(6) A person eligible for career or career-conditional appointment under § 315.606 of this chapter.

* * * * *

5 C.F.R. § 316.401 (1972) further provides:

Purpose and duration. The Commission may authorize an agency to make a temporary limited appointment to meet an administrative need for temporary employment, such as to fill a temporary position or a continuing position for a temporary period. An agency may make a temporary limited appointment only for a definite period of 1 year or less.

[3] FPM ch. 316, subch. 4–1(a) provides:

Purpose of temporary limited employment. Under conditions authorized by the Commission, temporary limited employment is used to meet administrative needs such as filling temporary positions, or filling a continuing position for a temporary period. The following types of positions are filled by temporary limited appointments:

(1) Positions not expected to last more than one year;

(2) Seasonal positions (i.e., positions involving periodically recurring employment other than the career-type positions);

(3) Part-time and intermittent positions that are not clearly of a continuing nature; and

(4) Continuing positions, when temporarily vacated for periods of less than one year, or when filled by persons 70 years or older.

All citations to the FPM reflect the language in effect at the time of corresponding factual occurrences in this case. Minor revisions, of no significance for purposes of this case, have subsequently been made to certain sections cited.

c. Appointment for 700 hours or less.

* * * * *

(4) *Handicapped applicants.* To facilitate the employment of persons with severe physical handicaps and those who have been restored to mental health after treatment for mental or emotional disorder, agencies are encouraged to use this authority to provide initial or trial temporary employment for these applicants. Temporary limited appointment for not to exceed 700 hours may be made even though the position to be filled is a continuing one.

The purpose of this special appointment procedure for the severely handicapped is explained in FPM ch. 306, subch. 4–2:

4–2. Appointment [of the physically handicapped]

* * * * *

c. Using trial appointment procedure. Many severely handicapped people need a trial appointment because they are unable to obtain competitive appointment even with examination modification or referral service, or both, through the Coordinator program. One barrier to their employment may be inability to be selected competitively even though they have been trained and are qualified to perform the job tasks. Another barrier may be employer reluctance to hire them for fear they will not be able to perform on the job efficiently or safely, or fit in with and be accepted by the work force. These obstacles can often be overcome by use of the 700-hour temporary trial appointment authority (chapter 316, section 4–7c(4)). * * *

Defendant made no changes in its recording of plaintiff's employment status at the completion of the initial 700 hours of plaintiff's employment, which would have occurred on or about September 6, 1972. On October 18, 1972, plaintiff asked the agency personnel office if it would be possible to make arrangements for him to qualify for health insurance. Upon further inquiry into this matter and ascertainment of plaintiff's satisfactory job performance, defendant attempted to correct its original error of classifying plaintiff's hiring as a temporary limited appointment not to exceed one year. On November 26, 1972, defendant purported to convert by reinstatement plaintiff's appointment to one of career-conditional status under

authority of 5 C.F.R. § 315.401 (1972), which provides, in relevant part:

> Reinstatement.
>
> (a) *Agency authority.* An agency may reinstate a person who had a competitive status or was serving probation when he was separated.
>
> * * * * *

The Appeals Examining Office of the CSC subsequently ruled that the conversion by reinstatement to career-conditional status should have an effective date of September 6, 1972, at the end of plaintiff's first 700 hours of employment.

Although plaintiff's work product was considered quite satisfactory throughout his employment with the Archives, some problems developed in the relationship between plaintiff and certain other employees of the Archives. Defendant contends that there were several incidents where plaintiff either exhibited displays of temper or wrote offensive notes to fellow employees. In light of these alleged difficulties, plaintiff was temporarily assigned in February 1973 to the National Audio-Visual Center, a branch of the Archives, in Suitland, Maryland.

After unsuccessfully attempting to be returned to his normal job assignment, plaintiff wrote to Congressman Clark regarding his job situation on May 24, 1973. The Congressman, in turn, wrote to GSA on June 7, 1973, inquiring into the circumstances of plaintiff's job assignments. GSA responded to the Congressman's inquiry by forwarding a report on July 10, 1973 concerning plaintiff's employment record. The report concluded by stating that plaintiff was to be terminated. By letter of July 18, 1973, plaintiff was notified of his separation, effective August 1, 1973.

Since defendant considered plaintiff to be in probationary status at the time of his termination, the notification of separation informed plaintiff that, besides this notice itself, his procedural rights were limited to an appeal to the CSC only on those grounds specified in 5 C.F.R. § 315.806

(1973).[4] These grounds include discrimination based on race, color, religion, sex, national origin, political reasons, marital status, or physical handicap. Defendant admits plaintiff was not afforded those rights to which a person in competitive status (*i.e.*, one who completed a one-year probationary period under a career-conditional appointment, as defined in 5 C.F.R. § 212.301 (1973)) would be entitled under 5 U.S.C. § 7501, specifically, notice of proposed adverse action and an opportunity to make a written reply.

Plaintiff subsequently exhausted his administrative remedies before the CSC. The CSC Appeals Examining Office held that plaintiff was still in his probationary period when terminated because the agency had the authority to appoint plaintiff to a temporary limited appointment not to exceed 700 hours at the time he was hired. The Appeals Examining Office viewed as a nonprejudicial error the erroneous recording of plaintiff's hiring as a temporary limited appointment not to exceed one year. Plaintiff's claims that his termination was a result of discrimination due to his physical handicap and that his dismissal was made in response to the fact that he wrote Congressman Clark were also denied. The CSC Appeals Review Board affirmed the decision of the Appeals Examining Office.

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[4] 5 C.F.R. § 315.806 (1973) provides, in relevant part:

* * * * *

(b) *On discrimination.* (1) An employee may appeal under this subparagraph a termination which he alleges was based on discrimination because of race, color, religion, sex, or national origin. The Commission refers the issue of discrimination to the agency for investigation of that issue and a report thereon to the Commission.

(2) An employee may appeal under this subparagraph a termination not required by statute which he alleges was based on partisan political reasons or marital status or a termination which he alleges resulted from improper discrimination because of physical handicap.

* * * * *

5 C.F.R. § 315.804 (1973) provides:

Termination of probationers for unsatisfactory performance or conduct. When an agency decides to terminate an employee serving a probationary or trial period because his work performance or conduct during this period fails to demonstrate his fitness or his qualifications for continued employment, it shall terminate his services by notifying him in writing as to why he is being separated and the effective date of the action. The information in the notice as to why the employee is being terminated shall, as a minimum, consist of the agency's conclusions as to the inadequacies of his performance or conduct.

A person appointed to a career-conditional position must normally serve a one-year probationary period before competitive status is acquired. 5 C.F.R. §§ 212.301, 315.302, and 315.802 (1973). Only persons in competitive status are eligible for the procedural safeguards of 5 U.S.C. § 7501, in light of 5 C.F.R. § 212.401 (1973). Persons serving a probationary period are entitled only to the notice provisions of 5 C.F.R. § 315.804 (1973) and appeals to the CSC based on certain acts of discrimination under 5 C.F.R. § 315.806 (1973), unless the reasons for dismissal are based on conditions arising before that individual's appointment. If we were to decide that plaintiff's May 8, 1972 appointment placed him in career-conditional status, thus commencing the one-year probationary period on that date, then plaintiff should have been afforded the procedural rights to which he was entitled by 5 U.S.C. § 7501 because the one-year probation would have expired before his termination on August 1, 1973.

The basis of defendant's argument that plaintiff was a probationary employee at the time of his termination, not entitled to the procedural rights of 5 U.S.C. § 7501, is that defendant intended to make plaintiff's hiring a temporary limited appointment not to exceed 700 hours and had the authority to do so, in light of plaintiff's severe handicap, under FPM ch. 316, subch. 4–7(c)(4). Plaintiff maintains that he had held career-conditional status in Government employment within three years prior to his hiring by the Archives, was on an appointment register, and should have been appointed as a career-conditional, rather than a temporary, employee.

We hold that plaintiff's hiring on May 8, 1972 placed him in career-conditional status as of that date. Plaintiff's one-year probationary period had expired before his termination on August 1, 1973, and he was thus in competitive status at that time. Consequently, plaintiff was entitled to the procedural safeguards of 5 U.S.C. § 7501, which were denied him.

There is no question that plaintiff could have been given a career-conditional appointment when hired by the Archives. Plaintiff was on an appropriate appointment register, and had been employed by the Government in

career-conditional status within three years prior to his hiring. This eligibility for career-conditional status was implicitly acknowledged by defendant through the alleged "conversion by reinstatement" of plaintiff's status to career-conditional on November 26, 1972. Defendant utilized 5 C.F.R. § 315.401 (1972) for this action, a regulation authorizing reinstatement within three years following the date of separation for those who had held career-conditional status. There is nothing in either the regulations or the FPM that mandates that all severely handicapped persons must be hired through the special limited appointment procedure. Plaintiff's previous employment experience with the Government exemplifies this fact.

If we were to hold for defendant in this case, we would effectively be placing plaintiff in a less beneficial employment status, on the basis of his physical handicap, than the erroneous temporary limited appointment not to exceed one year classification in which he was ostensibly hired. Under the facts of this case, this is an unacceptable result. The temporary limited appointment not to exceed 700 hours is designed to aid the severely handicapped by actually giving them a chance to demonstrate, on a temporary basis, that they are capable of performing a job, where otherwise they might not receive such an opportunity. FPM ch. 306, subch. 4–2(c). The interpretation defendant seeks would discriminate against, rather than aid, the physically handicapped. Furthermore, our holding is consistent with the intent of Congress to avoid discrimination based on physical handicap in Government employment, as expressed in 5 U.S.C. § 7153 (1970), which provides:

> Physical handicap. The President may prescribe rules which shall prohibit, as nearly as conditions of good administration warrant, discrimination because of physical handicap in an Executive agency or in the competitive service with respect to a position the duties of which, in the opinion of the Civil Service Commission, can be performed efficiently by an individual with a physical handicap, except that the employment may not endanger the health or safety of the individual or others.

Where defendant is hiring a physically handicapped person, and chooses to restrict that appointment to a

temporary limited appointment not to exceed 700 hours, it is incumbent upon the agency to make the nature of the appointment clear in the hiring process. Absent such specification, the presumption should be that the handicapped person is entitled to the same appointment status that a non-handicapped person would receive. Defendant should not be permitted to take a provision designed to aid the handicapped and turn it to plaintiff's detriment where the ground rules were not established at the time plaintiff was hired.

The denial of plaintiff's substantial procedural rights under 5 U.S.C. § 7501 renders the adverse action against him void, and thus entitles him to appropriate back pay. This policy has been expressed in a number of pay cases in this court, including *Gratehouse* v. *United States*, 206 Ct. Cl. 288, 296, 512 F.2d 1104, 1108 (1975), where the court stated:

> Where it is found that an adverse personnel action has been carried out in substantial violation of procedural regulation, it is a void action and the employee is entitled to recover any pay of which he has been illegally deprived.

See also Hanifan v. *United States*, 173 Ct. Cl. 1053, 1062, 354 F.2d 358, 364 (1965); *Garrott* v. *United States*, 169 Ct. Cl. 186, 198, 340 F.2d 615, 622 (1965). Since no genuine issue of material fact exists in regard to the procedural aspect of this case, disposition by summary judgment is appropriate under Rule 101(d).

Since our holding is based on the procedural issue, we need not address the questions of whether plaintiff was discharged either because of discrimination due to his physical handicap or as a result of his petitioning Congressman Clark in relation to his job. However, we would be remiss not to add that our holding seems particularly justified in light of the rather suspect nature of the charges against plaintiff. In transmitting the report concerning plaintiff's employment record upon which his termination was based to Congressman Clark on July 10, 1973, defendant admitted that it had "found his editorial work to be very satisfactory." The problem seemed to be more of a communications difficulty with his fellow

workers than anything else. In view of plaintiff's particular physical handicap, it is not surprising that certain communications problems would arise. The nature of the charges brought against plaintiff, the handicap involved, and the commitment of Congress as expressed in 5 U.S.C. § 7153 to avoid discrimination based on physical handicap in Government employment would place a heavy burden upon the agency to show that such a dismissal "will promote the efficiency of the service", in the language of 5 U.S.C. § 7501(a).

Defendant's motion for summary judgment is denied, and plaintiff's cross-motion for summary judgment is granted. Plaintiff is entitled to recover back pay and allowances as provided by law, less appropriate offsets, from the date of his dismissal on August 1, 1973. The case is remanded to the Trial Division for further proceedings under Rule 131(c) to determine the amount of recovery due plaintiff. The trial judge shall also recommend to the court whether or not reinstatement for plaintiff should be ordered, in light of the particular circumstances of the case.

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564 F.2d 48

ESTATE OF AZALEA SMITH DOWNS, ABB HOWARD, INDEPENDENT EXECUTOR v. THE UNITED STATES

[No. 32-76. Decided October 19, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Taxes; estate tax; inclusions in gross estate; Powers of Appointment Act of 1951; retroactivity and constitutionality; former Texas resident.—Decedent's husband, a former resident of Texas, died on December 30, 1947, leaving decedent the residue of his estate for her exclusive use and benefit during her lifetime with full power to sell or to otherwise dispose of the property in any manner and upon such terms as she elected; upon her death the remaindermen were to receive only what she might have chosen not to appropriate. The parties agree that the power was a "general power of appointment" within the

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lexicon of the Powers of Appointment Act of 1951. Following the widow's death in September 1971, the CIR included the value of the property held under the power within her gross estate and computed the estate tax due on that sum. Plaintiff paid the tax so assessed, but contends that the property the widow held under her power should not have been included because the power was excludable from the gross estate under the tax law in force in 1947, and was not constitutionally made includable thereafter. For purpose of decision, the court assumes, *arguendo*, that the language of the husband's will would have been effective to avert a second tax under Sec. 811(f) of the 1939 Code as amended by the Revenue Act of 1942 and that Treas. Reg. 105 was not effective to accomplish the contrary. For the reasons given, the court *declines* to hold the 1951 Act unconstitutional, *per se*, or as applied in this case. Accordingly, plaintiff is not entitled to recover. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

Taxes; revenue laws; construction and operation; retroactive tax legislation.

[1] Questions respecting the retroactivity of a taxing statute cannot be simplistically answered, but require analysis of the fairness of the provisions under all the circumstances.

Internal Revenue ⚖130

Taxes; estate tax; gross estate, inclusions in; Powers of Appointment Act; constitutional application to antecedently created property interests.

[2] Assuming, *arguendo*, that the language of the will of decedent-devisee's husband creating a general power of appointment in the wife's favor would have been effective to avert a second tax under the federal estate tax law as it existed prior to the Powers of Appointment Act of 1951, where Treas. Reg. 105 was noticed prior to execution of the will, thereby giving reason to anticipate that the 1942 Act did not exclude the widow's broad discretionary power over the property and to expect that the value of the property subject to the power might be includable in her gross estate, and where it has not been shown that Texas law deprived the widow of an opportunity timely to renounce or disclaim the power as provided in the 1951 Act, the 1951 Act is not here vulnerable to constitutional attack for lack of due process or equal protection.

Constitutional Law ⚖229.1, 286
Internal Revenue ⚖45

Taxes; estate tax; gross estate, inclusions in; Powers of Appointment Act; constitutional application to antecedently created property interests.

[3] The court cannot hold the Powers of Appointment Act of 1951 unconstitutional on the basis of mere speculation as to what a state court would have done 20 years earlier to avert harm to the instant decedent estate, in a matter not governed by statute, nor by any reported precedential decisions and where the widow did not approach the state legislature or institute court proceedings to permit an

acceptable disclaimer or renunciation of her general power of appointment.

Internal Revenue ⇨45

Barry Bishop, for plaintiff. *Sander Shapiro*, attorney of record. *Clark, Thomas, Winters & Shapiro* and *Glen Wilkerson*, of counsel.

George L. Squires, with whom was *Acting Assistant Attorney General Myron C. Baum*, for defendant. *Theodore D. Peyser* and *Robert S. Watkins*, of counsel.

Before DURFEE, *Senior Judge*, NICHOLS and BENNETT, *Judges*.

NICHOLS, *Judge*, delivered the opinion of the court:

In this tax case, both plaintiff and defendant move for summary judgment. We grant defendant's motion.

Plaintiff is the estate of Azalea Smith Downs, whose suit to recover a refund of estate taxes allegedly overpaid requires us to consider the effect of the Powers of Appointment Act of 1951, Pub. L. No. 58, 65 Stat. 91 (1951), (now codified in 26 U.S.C. § 2041), (hereinafter 1951 Act) upon a power of appointment created while the prior law, section 811(f) of the 1939 Internal Revenue Code, as amended by the Acts of October 21, 1942, Pub. L. No. 753, and December 17, 1942, Pub. L. No. 809, 56 Stat. 1054, 77th Cong. (hereafter 1942 Act), was in force. Plaintiff's decedent, Azalea Smith Downs, a longtime Texas resident, died on September 17, 1971, possessing a power created under her husband's will written in November 1947, and probated following his December 30, 1947 death, in early 1948. It bequeathed her all the residue of his estate, "for her sole and exclusive use and benefit for and during her natural life," with full power to "sell, mortgage, pledge," etc., or "dispose of said property or any part thereof or the proceeds thereof in any manner and upon such terms as she may elect and in her sole discretion, to use and appropriate said property or the proceeds thereof at any time and in any manner she deems convenient for her use * * *" and upon her death the remaindermen (now, no

doubt, remainder persons) were to get only what she might have chosen not to appropriate.

That power vested in decedent such broad discretion over her husband's property that the parties agree the power was in the lexicon of the 1951 Act, a "general power of appointment," because it was exercisable in favor of the decedent, her estate, her creditors, or the creditors of her estate. Accordingly, the Commissioner of Internal Revenue included the value of the property held under the power within decedent's gross estate, and computed the estate tax due on that sum. Plaintiff paid the tax so assessed, but has since contended that the property decedent held under her power should not have been included, essentially because, plaintiff declares, the power was excludable from gross estates under the tax law in force at the time decedent inherited the power in 1947, and was not constitutionally made includible thereafter.

The 1942 Act excepted from the definition of taxable "powers of appointment" a power to appoint within a class limited, generally, to the "spouse of the decedent, spouse of the creator of the power, descendants of the decedent or his spouse, descendants (other than the decedent) of the creator of the power or his spouse," and others not here relevant. It is not easy to tell just by reading this language whether or not the Congress intended that the "spouse of the creator of the power" should be able to appoint herself, as the decedent here could, and be within the statutory definition of an excepted power. Treasury Regulation 105 holds that the exceptions stated in the 1942 Act would not embrace a power exercisable by a decedent in her own favor, even though she was, coincidentally, the spouse of the creator of the power. 43 Cum. Bull. 1081, 1088 (1943).

Plaintiff, on the other hand, relies solely on the statute, which contains no such limitation, at least none explicit, and says the regulation is plainly contrary to the statute and invalid. Neither we, nor the parties evidently, have located any court's opinion of the regulation's consistency with the statute. Since the validity of the 1943 regulation apparently was not reviewed while it was contemporary, we are reluctant now that its era has passed to open it to question. We have determined that even if plaintiff is right,

the 1951 Act is not vulnerable to constitutional attack by this particular estate at least. We assume, *arguendo,* for purposes of this decision, therefore, that the language of the husband's will would have been effective to avert a second tax under the 1942 Act and that the regulation was not effective to accomplish the contrary.

Plaintiff says the 1951 Act is invalid as retroactive legislation, but appears to concede that such retroactivity would not be unconstitutional in all cases because the statute provides relief to some estates whose decedents timely and effectively renounced their general powers. Property once held under such general powers would not be included after disclaimer or renunciation of the power, valid under state law. See 26 U.S.C. § 2041 and Treas. Reg. § 20.2041–3(d). Yet, plaintiff points out that during 1948 and 1949, decedent appointed several items of property under her power for her own benefit, so that, according to plaintiff, decedent could no longer renounce the power under Texas law. From this plaintiff concludes that the 1951 statute is unconstitutionally applied to this estate because Texas law deprived decedent of any opportunity after 1951 to utilize the relief provision which, plaintiff contends, is essential to the statute's constitutionality.

The parties' briefs and argument reflect their thorough disagreement; on virtually each of plaintiff's legal contentions, an issue is joined. Defendant invokes the general rule that the taxable event for applying the federal estate tax is the decedent's death, and the only applicable law is that then in force. Thus, defendant would have us look only to the date of decedent's death, in 1971, and apply section 2041 as the Commissioner did. Defendant's premise is valid, of course, but employing it here seems to beg, rather than answer, plaintiff's constitutional question.

Under our landmark decision in *First National Bank in Dallas* v. *United States,* 190 Ct. Cl. 400, 420 F.2d 725, *cert. denied,* 398 U.S. 950 (1970), retroactivity questions cannot be given simplistic answers, but require analysis of the fairness of the provision under all the circumstances. This case is followed in *Purvis* v. *United States,* 501 F.2d 311 (9th Cir. 1974). Both deal with the retroactive application of the Interest Equalization Tax Act of 1964, Pub. L. No.

88–563, 78 Stat. 809. Both lay great stress on the fact that before engaging in the transactions taxed, the taxpayers had actual notice that President Kennedy had asked Congress to enact the tax and make it retroactive to the date of his request. In line with the importance thus given to notice, we observe that the Texas lawyers who wrote the type of clause here involved may have thought it qualified for exclusion under the 1942 Act, but they could hardly have been unaware that the Internal Revenue Service considered that it did not. Regulation 105 shows on its face it was approved by the Acting Secretary March 10, 1943, and filed with the Federal Register the next day, giving 3½ years of notice to the date of the will. However right the lawyers may have been, and however confident they were right, they should have anticipated a contest. In the circumstances, it is not unfair to suppose their instructions from their testators preferred the importance of the fullest immediate protection for their widows to be, over the ultimate protection of heirs against double taxation, after the widows had followed their spouses into the grave. Moreover, if it was really as difficult to renounce or disclaim a power of appointment in Texas as alleged, this too should have been a warning signal to any properly advised Texas testator who wanted to create such a power for his future widow. The use of the clause thus is shown to reflect, or at least suggest the predominance of other considerations over the fear of double taxation in testators' minds. However, we are, as shown below, skeptical that Texas law was all that positive.

A reasonable estate planner we believe would have taken Regulation 105 as notice that the Treasury believed the 1942 Act did not exclude powers of the kind involved and should the courts hold otherwise, the Secretary would be before Congress asking for a closing of the loophole. It would have been hard for anyone to believe that certain powers of appointment should be taxed, and the one here involved avoid taxation.

Besides whatever notice the regulation gave, or despite it, Congress thought it also necessary in the 1951 Act to provide an escape hatch by which donees of general powers of appointment, or some of them, whether or not excepted

under the 1942 Act, could avert double taxation under the 1951 Act by disclaimer or renunciation.

If Congress provided means of escape for most donees of the 1942–1951 period, but left a few without that possibility, some jurists might deem that those few had a better constitutional case than if Congress had failed to protect anyone. The inquiry we deem decisive is whether, antecedently considered, the unavailability of the escape hatch for Azalea Smith Downs was so obvious that she was excused from even trying to use it. The keystone of plaintiff's argument is that Texas law prevented decedent from renouncing her power after 1951 in order to avail herself of the 1951 statute's relief provision. If plaintiff could demonstrate that this were so, we might agree that plaintiff had raised a substantial constitutional objection, or, at least, clothed herself in equities worthy of special notice.

The parties have researched Texas law thoroughly. There was no statute dealing with renunciation of powers until 1971. The only pre-1951 court decisions cited deal with widely different problems. For example, plaintiff seeks support for her statement of Texas law in *Torno* v. *Torno*, 95 S.W. 762 (Tex. 1906), which lends scant support as we construe it. *Torno* resulted from one legatee's attempt to avoid the distribution of his father's estate by will and to increase his inheritance at the expense of his siblings. The legatee had permitted his gift of real property to be sold in satisfaction of a debt owed to creditors, although immediately before suit the legatee repurchased the property intending to renounce his right to it under the will. On these facts, readers are hardly astonished to learn that the court spurned the legatee's attempt to take both against the will and under it. The court held:

> * * * [I]n purchasing the land from the interveners [the creditors], plaintiff recognized their title thereto and thereby accepted under his father's will, and is estopped from asserting any claim to the remainder [of the estate] * * *. [O]ne who takes property under a will cannot claim adversely to the provisions of such will other property therein devised to another. [95 S.W. at 763.]

Torno, however, does not establish plaintiff's proposition that one who accepts a legacy is automatically disabled from disclaiming any part of it. To the contrary, we might infer from the Texas court's willingness to give effect to the legatee's sale of the property accepted under the will, that the court would have also permitted the legatee to disclaim the gift gratuitously.

The most important and most relevant case for our purposes came down only in 1968, *First City National Bank of Houston* v. *Toombs*, 431 S.W.2d 404 (Tex. Civ. App.), after decedent's time to effect a renunciation had all but expired. It is not evidence of what she would have faced in 1951. In general, it holds that beneficiaries can renounce life estates willed to them, income from a trust, although they have accepted specific cash legacies. The court relies on the fact that the latter are separate from the former in the structure of the will. (It seems clear that our decedent's hypothetical renunciation would have applied to a single clause under which she had already exercised some powers.) A concurring judge indicates that, in his opinion, the distinction between renunciation of combined and separate gifts is sterile and slippery, productive of "nice" differentiations rather than practical benefit. Before us, defendant relies on the practical tolerance toward a partial renunciation, while plaintiff, naturally, stresses the conceptual separateness of the renounced and the accepted legacies. The meaning of the decision to us is the fluid state of the Texas law that it reveals as of as late as 1968, and the paucity of Texas authority to be discussed except that which deals with wholly unlike situations. The court finds a lack of guidance by Texas decisions and refers to a split of authority in other jurisdictions, whether benefits under the same will can be accepted in part, renounced in part, and makes its choice of what it deems the right rule. It would be reasonable to expect that state courts would be highly sympathetic to neutralizing anything alleged to be in the law which, in effect, would expose their residents to discriminatory double Federal taxation that residents of other states escaped. The words of the court in 1968, and dealing with a different problem, therefore leaves to speculation what the fate of a declaratory judgment

petition in 1951 by Azalea Smith Downs would have been. It would be natural to expect donees of powers to try what they could do under existing law. There is no record indicating that our decedent ever did so, nor does any reported decision indicate that anyone else did despite the alleged common use of the clause involved.

In this circumstance, it would seem that no reasonably competent Texas lawyer, consulted after 1951 by our decedent, should have advised that to attempt a partial renunciation would be hopeless. He would have been aware that probate judges are not in the habit of freezing previously fluid law in a manner to cause hardship to devisees and frustrate testators' intentions. We may take judicial notice: what judges say the law is largely is influenced by the nature of the controversies put before them for adjudication.

Texas statute law did not deal with renunciation until 1971. Then the legislature adopted section 37A of the Probate Code, 62d Leg. p. 2954, Ch. 979, § 1, effective August 30, 1971. Azalea Smith Downs died only 18 days later, too late to invoke the procedure prescribed thereunder. The parties have much debated this statute, but it is of remote relevance, if any. It allows partial disclaimers, provided it is not a matter of accepting benefits and disclaiming burdens and provided the disclaiming party has not taken possession or exercised control over the property. The legislature may have supposed that 1971 being 20 years after 1951, no powers of decedent's type remained to renounce. If decedent had been going to disclaim, obviously she should have done it long before 1971. If she had done it only within three years of death, it would have been presumed, absent a showing to the contrary, to have been done in expectation of death. Internal Revenue Code of 1954, section 2035.

If decedent were shown to have approached the legislature, or instituted court proceedings (perhaps a declaratory judgment action as in *Toombs, supra*), to establish her right to renounce within any reasonable time after 1951, and without success, or if she had even consulted counsel and been advised to abstain from such proceedings because they would have been futile, we would have an entirely different

case. Then it might be persuasively urged that the congressional escape hatch furnished illusory escape for her and her estate. As things were, if she preferred to retain during her lifetime the powers her husband had wanted her to have while she needed them, instead of surrendering them early to shelter others from taxation after she was gone, she would have been perfectly logical, perfectly human, and perfectly within her rights. Her representatives cannot persuasively urge now that she was prevented from doing something she never wanted to do so far as any showing has been made.

We think that to accuse Congress of passing retroactive legislation here, it would be necessary to show that it locked her into a situation created between 1942 and 1952, without the possibility of escape, giving that situation tax consequences not intended or foreseen when it was created. It has not been shown that, as of 1951, it would have been hopeless for her to attempt escape. It has not been shown she wanted to escape. In such circumstances, whatever wrong Congress may have done to others, it did none to her. We cannot hold an Act of Congress unconstitutional on the basis of mere speculation as to what the Texas courts would have done in 1952, in a matter not governed by statute, nor by any reported, precedential decision, and in a case the decedent did not choose to bring. If the case law had been hopelessly adverse, which it was not, we question if Congress might not have been reasonable in anticipating state legislation to conform to its own, *i.e.*, to permit a disclaimer that Congress would accept as sufficient. It is common knowledge that state legislators often do alter state laws to enhance the advantages state residents can enjoy under Federal law. If the Texas legislators did not act, it may have been only because no one asked them to. *Vigilantibus, non dormientibus, leges servient.*

At any rate, plaintiff now imputes to Congress a failure to accord due process or equal protection to a decedent estate, although the state legislature and state courts had a last clear chance for 20 years to avert harm to the estate, if the decedent had only asked for it, which she never did so far as we are told.

Accordingly, we decline to hold the statute unconstitutional, *per se*, or as applied in this case. We determine, therefore, that the plaintiff is not entitled to recover. Plaintiff's motion for summary judgment is denied, the defendant's cross-motion for summary judgment is granted, and plaintiff's petition is dismissed.

ROSITA ERDWEIN, ADMINISTRATRIX OF THE GOODS AND CHATTELS OF HYMAN L. ERDWEIN v. THE UNITED STATES

[No. 819–71. Decided October 19, 1977]

ON THE PROOFS

Civilian pay; dismissal; arbitrary and capricious action; entitlement to back pay.—Plaintiff, a former GS–9 Department of Agriculture meat inspector, died on January 27, 1976 after instituting the present suit for back pay he would have earned had he not been suspended and separated, as well as collateral relief. Plaintiff was suspended from his position on March 18, 1965, his suspension was lifted from March 31 through June 4, 1965 to allow exhaustion of his accumulated annual leave, and effective June 5, 1965 the suspension was reimposed. The suspension resulted from plaintiff's alleged misconduct in connection with concealment and disposition of certain boxes of suspect meat, and grew out of an indictment by the grand jury of New York County on March 10, 1965 against plaintiff and others on charges of conspiracy to obstruct justice. On June 18, 1968 the indictment against plaintiff was dismissed on motion of the district attorney. A letter notifying plaintiff of his proposed suspension informed him that in event the legal proceedings and the agency investigation disclosed no misconduct warranting serious disciplinary action, the suspension action would be canceled, reference thereto would be removed from his records, and pay otherwise due him would be restored. On July 2, 1968 plaintiff was notified of his proposed removal on two charges; the first part of the first charge was based on the same circumstances underlying the indictment and the second part accused plaintiff of permitting the owner of the meat (Merkel) to ship it by failing to prevent its removal. The second charge, not previously raised, accused plaintiff of accepting theater tickets from Merkel. Plaintiff was dismissed effective October 19, 1968. During administrative appeal proceedings, the Civil Service regional director found insufficient credible evidence to support the first part of the first charge, but sustained the second part thereof although

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the latter required the same evidence which he had just rejected; he sustained the second charge. The Board of Appeals and Review, while indicating that the second charge in and of itself might not warrant removal, concluded that this charge considered with the sustained portion of the first charge justified removal. The court concurs in the finding of the trial judge that the second portion of the first charge was not supported by any credible evidence and that the second charge did not constitute basis for removal, and his conclusion that the decision to remove plaintiff was arbitrary, capricious and not supported by substantial evidence. Plaintiff is entitled to back pay for the period from his dismissal to the date of his death. The court also *holds* that plaintiff is entitled to back pay for the time he was suspended pending outcome of the indictment and the agency investigation in view of the promise made by the agency. The amount of recovery and appropriate collateral relief to which plaintiff is entitled, subject to applicable offsets, if any, will be determined under Rules 131(c) and 147(c).

Civilian pay; adverse action; suspension; indefinite v. temporary.

[1] Where plaintiff was suspended from his position pending outcome of criminal proceedings against him, the suspension was lifted after 11 days only to allow exhaustion of plaintiff's accumulated annual leave, and it was then reimposed as contemplated by both parties, the initial suspension was indefinite in nature and cannot be considered an adverse action of less than 30 days within the purview of Civil Service regulations, Part 752–C, requiring appeal from the action within 10 days. To conclude that the suspension was temporary elevates form over substance.

United States ⚖36

Civilian pay; dismissal; arbitrary and capricious action; what constitutes.

[2] Where plaintiff was removed on the second portion of a misconduct charge based on speculation and conjecture and on the same evidence which the Civil Service Commission concluded was not credible to support the first and more serious part of the charge, and also on a charge not previously used to launch plaintiff's suspension over 3 and a half years earlier and which the Board of Appeals and Review acknowledged might not in and of itself warrant removal except when considered in connection with the sustained portion of the first charge, the decision to remove plaintiff was arbitrary, capricious and not supported by substantial evidence.

United States ⚖36

Civilian pay; claim for back pay; suspension without pay.

[3] Where the employing agency, in suspending plaintiff, advised him that the suspension action would be canceled and pay otherwise due him would be restored in event the indictment against him and the agency investigation disclosed no misconduct warranting serious disciplinary action, the suspension must be retroactively treated as one with pay upon dismissal of the criminal proceedings and failure of the agency investigation. As revealed in the administrative hearings and

the trial in this court there was no credible evidence of wrongdoing or violation of regulations on plaintiff's part that could fairly lead to imposition of serious disciplinary action. *Jankowitz* v. *United States*, 209 Ct. Cl. 489, 533 F.2d 538 (1976), *distinguished*.

United States ⚖39(8)

John I. Heise, Jr., attorney of record, for plaintiff. *Leonard J. Meiselman*, of counsel.

LeRoy Southmayd, Jr., with whom was *Assistant Attorney General Barbara A. Babcock*, for defendant.

Before DURFEE, *Senior Judge*, NICHOLS and BENNETT, *Judges*.

BENNETT, *Judge*, delivered the opinion of the court:

The plaintiff in this civil service pay case was, until January 27, 1976, Hyman L. Erdwein, a former GS–9 meat inspector in the Department of Agriculture whose suspension and dismissal gave rise to this action. On that date, Hyman Erdwein died.[1] The opinion of Trial Judge Louis Spector, filed July 27, 1976, vindicated plaintiff's efforts to overcome the adverse actions, but plaintiff did not live to know it. The trial judge found that plaintiff was entitled to back pay for both the time he was suspended[2] from duty and the aftermath of his subsequent dismissal, because the charges underlying those adverse actions were utterly without merit. Defendant does not contest the trial judge's disposition of the claim regarding dismissal, but now brings the case here on request for review of the opinion insofar as it contemplates award of back pay during the period of suspension. We reach virtually the same result as did the trial judge on this point, though by a different course.

Since our conclusion rests in part on facts as found by the trial judge, disclosing the Government's failure at all stages of the proceedings in plaintiff's case to bring forward any credible evidence implicating him in wrongdoing, we set out those facts at length, borrowing heavily from the

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[1] His widow and administratrix has been substituted as party plaintiff. Ct. Cl. Rule 66(a). However, references to plaintiff herein will mean Hyman Erdwein.

[2] Except for the period from March 31 through June 4, 1965, when his suspension was lifted to permit exhaustion of his accumulated annual leave.

trial judge's findings and opinion.[3] Plaintiff was first employed by the Department of Agriculture on November 17, 1941, and served continuously in that department (except for his military service during World War II) until his suspension effective March 18, 1965, and his subsequent removal 3 years and 7 months later on October 19, 1968. He had been a career civil servant, with entitlement to veterans' preference.

At the time of his suspension and subsequent removal, plaintiff was classified as a meat inspector, GS–9, in the Marketing and Consumer Services Meat Inspection District Office at New York City. He had at that time about 24 years of satisfactory service as a meat inspector and was considered competent, diligent, trustworthy, and reliable by his superiors. He had received a sustained superior performance award in 1962, and in his union, the American Federation of Government Employees, plaintiff was currently serving as president of the Eastern Council of AFGE locals.

When the events hereinafter described took place on December 11, 1964, plaintiff was on duty as a meat inspector at the Merkel, Inc., plant, and across the street at the A & P facility, in Jamaica, New York. The Merkel plant was at that time the largest meat processing facility in the New York metropolitan area.

Plaintiff had been assigned to the Merkel plant, along with two other inspectors (Messrs. Thompson and Fellner) since June 1964. One of the reasons plaintiff had been assigned to Merkel was that the Marketing Service had received some complaints about the plant and wanted competent inspectors on duty to control operations. Plaintiff had a reputation for being strict, but for providing good inspectional results. The huge Merkel plant was divided into three duty stations, namely, the two upper floors, the first floor and basement, plus the A & P facility, and all night operations. On December 11, 1964, plaintiff was assigned to first floor, basement, and the A & P facility,

[3] The trial judge's findings and opinion have been furnished to the parties. The findings are not printed herein since those relied upon by the court, and necessary to the result, are contained in this opinion.

Fellner was assigned to the upper two floors, and Thompson supervised all night operations.

Plaintiff reported for work at 7 a.m. on Friday, December 11, 1964. From Monday through Thursday (December 7 through 10) he had not been at the plant, but had been in Washington, D.C., for a labor management meeting with Department of Agriculture officials. On December 11, the day of plaintiff's return from Washington, the commissioner of the New York Department of Markets, Albert S. Pacetta, had been asked by the Manhattan district attorney's office to conduct a search at the Merkel plant on a tip that contaminated meat or horsemeat was being processed there as frozen beef. About noon that day, the commissioner called the Manhattan office of the U. S. Department of Agriculture and asked a Dr. Abbie J. Logie, then assistant inspector in charge of the New York Station Meat Inspection Division, for an inspector to accompany him on an important matter at the Merkel plant which Pacetta declined otherwise to describe. Dr. Logie advised that he would be unable to provide anyone at that time, but later that afternoon he was able to contact a Dr. Irving J. Kahn by telephone, and Dr. Kahn, a veterinary supervisor, was the one who eventually went to the Merkel plant as hereinafter related.

Commissioner Pacetta arrived at the Merkel plant in the middle of the afternoon of December 11, accompanied by about six members of his staff. He entered the premises from the rear, in the area of the shipping and receiving dock, and told Merkel employees that he was assuming jurisdiction over the plant to conduct an inspection. He directed his staff to stop all traffic and to secure the premises.

Plaintiff came to the shipping and receiving dock, identified himself as a federal inspector, and was advised by Pacetta that he was looking for a shipment of about 500 fifty-pound boxes suspected of containing horsemeat. Plaintiff and Inspector Fellner then accompanied Pacetta and his staff as they searched freezers and coolers in an effort to locate the boxes. At freezer No. 3 in the basement, they found a pile of boxes pushed together on skids in one corner. They were labeled "beef trim." Plaintiff requested

Merkel employees to open the boxes, and after examination advised those present that the meat was not beef trim because it was in solid chunks. Plaintiff informed Pacetta that this must be the shipment he was searching for, and he added that in his opinion there were more than 500 boxes. Pacetta agreed, and then disclosed that he was actually looking for about 700 boxes.

Plaintiff left the freezer and immediately called his main office from a nearby phone in the hall. He spoke to Dr. Logie informing him that Pacetta was at the plant, and that plaintiff had been asked whether he could identify the frozen meat as horsemeat. Plaintiff told Dr. Logie the product looked suspiciously like horsemeat. Because positive identification was impossible without a laboratory test, Dr. Logie instructed plaintiff to take samples for submittal to the Beltsville, Maryland, laboratory for seriological examination. Pacetta was then advised that the federal inspectors would take samples. Some frozen blocks were put through a frozen meat cutter and samples were put in plastic bags by Inspector Fellner. Thereafter, plaintiff engaged in a search for the invoices or receiving tickets relating to the suspect meat. Later that day, shortly after 5 p.m., Inspector Fellner also spoke to Dr. Logie to advise him that a total of approximately 790 boxes were involved, according to a receiving ticket which had meanwhile been produced as a result of plaintiff's efforts.

Plaintiff had no advance knowledge or notice of the suspected shipment, nor of its movement into the Merkel plant, presumably on the previous day. As earlier stated, he had been in Washington, D. C., during the prior 4 days.

While the investigation was in progress, Norman Lokietz, president and co-owner of Merkel, arrived and asked what was occurring. When informed, he demanded that the suspect meat be removed from his plant. Pacetta refused to permit its removal. After discussion and movement of some meat back and forth, the suspect product was consolidated in freezer No. 3, and isolated so that no intermingling with other boxes of meat could occur. Later that day, between 6 p.m. and 6:30 p.m., Inspector Fellner secured that freezer with a numbered, metal, USDA seal pending further orders from Pacetta or his

department. In addition, Pacetta's staff affixed a paper seal to the freezer door.

About 4:30 p.m., plaintiff received a call from the A & P facility, which was part of his duty station. He was advised that they were finishing their operation for the day, so he went across the street, locked up the USDA brands, checked for edible fat content, and then returned to the Merkel plant. About 5 p.m. Commissioner Pacetta indicated that he wished to leave, and plaintiff directed him toward the back platform. Plaintiff then went upstairs toward his office in the plant. As Pacetta was leaving, the aforementioned Dr. Kahn was arriving in response to Dr. Logie's earlier-described call.

Subsequent events put the time of Pacetta's departure at issue. The trial judge concluded that this occurred between 5 p.m. and 5:30 p.m., a finding which defendant does not dispute. When Dr. Kahn arrived, he was met by plaintiff. Together they inspected the boxes which had been isolated in freezer No. 3, and Dr. Kahn then directed the federal inspectors to pack the samples of suspect meat in dry ice for shipment to the Beltsville laboratory on the following Monday. Plaintiff remained with Dr. Kahn until shortly before 6 p.m., following which he changed clothes, made his final report entries, signed out on his time slip, and left the Merkel plant shortly after 6 p.m. Dr. Kahn also left shortly after 6 p.m.

Plaintiff proceeded to his car parked across the street and drove to Greenport, Long Island, located nearly 100 miles away at the northeast end of Long Island. This was late on a Friday and traffic conditions were typically heavy and roads clogged with commuters and others leaving the city for points east. Plaintiff arrived in Greenport at 9 p.m. He stayed there for two nights of union meetings, and did not return to the Merkel plant on Saturday, December 12, 1964. Meanwhile, Inspector Fellner remained at the Merkel plant until shortly after 7 p.m. on December 11, at which time he was relieved by the night inspector, Thompson, who had arrived about 6:30 p.m. On the next day, Saturday, December 12, 1964, Inspector Fellner returned to the Merkel plant to count the boxes which had been embargoed. He found the seals which had been placed

on the door had been broken, and this was explained to him.[4] He then counted the 790 boxes of embargoed meat. These boxes are not in issue.

At some time after Commissioner Pacetta left the Merkel plant, certain Merkel employees met with Norman Lokietz and made plans to move and did move some other frozen meat, which probably was horsemeat. This meat had neither been seen nor embargoed by Commissioner Pacetta and Department of Agriculture inspectors. The trial judge found the record entirely devoid of credible evidence that plaintiff knew about this meat or could have or did take part in the employees' meeting or in any planning at that meeting for removal of it later that evening. Equally lacking, the trial judge found, was probative evidence that plaintiff could have been or was aware that such plans were being made by others or that the suspicious meat was removed.[5] Again, defendant does not contest the trial judge's determination.

The adverse actions of which plaintiff complains grew out of an indictment returned by the grand jury of the county of New York on March 10, 1965, charging Charles Anselmo (supplier of the suspect meat to Merkel), Norman Lokietz, Inspector Fellner, and plaintiff with conspiracy to obstruct justice. By letter dated March 16, 1965, plaintiff was advised that he was suspended without pay effective March 18, until the outcome of the proceedings resulting from the indictment was known or until the Agriculture Department had completed its own investigation into the matter. The letter stated in part:

> In the event that the legal proceeding against you and the investigation *disclose no misconduct* on your part

[4] The seals which had earlier been placed on freezer No. 3 were broken during the night to permit a member of the Merkel staff to ship some processed, nonembargoed meat in the freezer. The 790 boxes of embargoed meat were not disturbed.

[5] The trial judge based this fact-finding on the absence of either time or motive on plaintiff's part, as disclosed by the record, for him to take part in or know of the employees' planning or actions. Several witnesses testified that plaintiff had already departed on his trip to Greenport and was not present when the meeting was conducted. The trial judge gave little weight, appropriately, to unsworn statements in the administrative record placing plaintiff at the meeting, statements made by a high Merkel officer and the relatives of two other such officers. Defendant offered no witnesses at trial, but chose to stand on the unsworn statements, which were overwhelmingly contradicted by the live testimony.

which would warrant serious disciplinary action, this suspension action will be canceled and all references thereto removed from your official record, and *pay otherwise due you will be restored.* [Emphasis supplied.]

Plaintiff's suspension was temporarily lifted, from March 31 through June 4, 1965, to allow exhaustion of his accumulated annual leave. Then, by letter dated May 28, 1965, defendant reimposed the suspension effective June 5, reiterating in that letter the above-quoted assurances of correction of records and restoration of pay. Plaintiff immediately protested the suspension and asked for a hearing and restoration to duty pending the hearing. However, action on this request was also held in suspension, until completion of the criminal proceedings or the Department's investigation.

On June 18, 1968, about 3 years and 3 months after its issuance, the indictment against plaintiff was dismissed by the Supreme Court of the State of New York, County of New York, on motion of the district attorney. Plaintiff's attorney promptly advised the Civil Service Commission of the fact on June 20, requesting that the Agriculture Department be directed to restore plaintiff to active duty retroactive to the date of his suspension.

The Government's response was a letter to plaintiff dated July 2, 1968, proposing to remove him on two charges of misconduct. The first charge was based on the same circumstances underlying the indictment dismissed on June 18. This charge was divided into two parts. The first part accused plaintiff of attending a meeting in Norman Lokietz' office during the afternoon or evening of December 11, 1964, of advising those present of the location of 62 or 67 boxes of meat similar to those previously embargoed by Commissioner Pacetta and the federal inspectors, and of suggesting that the meat "should be gotten rid of by immediate processing or movement since Mr. Pacetta had not seen or raised a question about these boxes." The second part of this charge accused plaintiff of permitting Merkel people to ship the described meat, by failing to prevent such shipment.

The second charge was a new matter, not previously raised. It accused plaintiff of accepting gifts, gratuities, and

favors in 1964, alleging that on four specified occasions he had received theatre tickets from Merkel. It is true that Merkel provided the tickets, when plaintiff placed orders for them through Norman Lokietz, but it has been established administratively, and the trial judge found (again without present opposition from defendant), that on each occasion plaintiff paid full cash for the tickets, which included the price of the ticket plus the brokerage fee involved.

Plaintiff replied in writing to these charges on August 7, 1968, denying them in full. He asserted that the first charge was vague and lacking in specificity, and that the second did not describe conduct contrary to regulations. An oral reply was made on September 25, 1968, before Dr. C. F. Diehl, director of the Northeastern District Meat Inspection Office at Philadelphia. It was Dr. Diehl's understanding that his function as an "oral reply officer" was to listen, report, and recommend. It was his further understanding that the purpose of the oral reply was to aid an aggrieved employee who could not write well. In this way, he felt, the employee could reply orally to someone in the Department, who could then send it to higher authority in writing.

Dr. Diehl was not supplied with any information, documents, or evidence other than the charges. He declined to make a recommendation at all on the first charge (suggesting and permitting removal of the meat) because he felt that he did not have enough information to make a recommendation on it, though he questioned the validity of the charge in his report.

On the second charge, Dr. Diehl drew on his own general, personal experience to the effect that "getting theatre tickets in the open market is difficult and usually at much higher prices." On the basis of that personal impression, he concluded that obtaining them constituted a favor.[6] He

[6] On the basis of the evidence elicited at trial, the trial judge found to the contrary. He stated in his opinion:

"Plaintiff could have obtained the theatre tickets himself through other sources, such as the box office or another agency. He chose to order the tickets through Merkel, as did other inspectors * * *, and Merkel employees, because it was more convenient. Plaintiff did not receive his tickets any sooner by this practice, but ordering them through Merkel would save plaintiff from having to go downtown to

recommended that plaintiff be removed on this second charge. Thereafter, by notice dated October 11, 1968, the director of the agency's personnel division advised plaintiff that the charges were "proved" and warranted his removal. He was thereupon removed effective October 19, 1968.

In response to plaintiff's timely appeal of the dismissal action, the agency scheduled a hearing for January 21, 1969, at which 14 witnesses appeared for plaintiff, and two on behalf of the Government. The hearing examiner, Herbert L. Perlman, sustained plaintiff's removal, but did so on reasoning exactly the opposite of Dr. Diehl's. Acknowledging that his findings were not free from doubt, the examiner upheld the agency on the first charge, concluding from the evidence that plaintiff did not "account for all his time that afternoon" of December 11, 1964, so as to negate his attendance at the meeting in Norman Lokietz' office. However, on the second charge, he found that "the agency has failed to sustain its burden of proof that appellant [plaintiff] did not pay for the tickets in issue." He declined to rule on whether plaintiff's acquiring the tickets through Merkel constituted a favor in violation of regulations, for "such determination is not our function in this proceeding."

Plaintiff then appealed to the Civil Service Commission's New York office. After a hearing, the Commission's

reserve or pick up tickets. The tickets ordered were left at the box office in plaintiff's name for pick up on the night of the performance.

"The evidence shows that tickets were readily available on those occasions. In each case they were ordered several weeks in advance, and in order to provide maximum flexibility and availability, plaintiff would request any evening during any week in which he was not working nights.

"A professional ticket agent, engaged in the business since 1947, testified under oath at trial from the results of his research regarding the four performances involved. He testified that they were not sold out for the entire week embracing in each case the date on which plaintiff attended the theatre. The witness testified that by selecting entire weeks within which tickets were acceptable, plaintiff attended shows for which tickets were readily available. The seats were not particularly good and, on one of the four occasions, plaintiff inconveniently attended a show on a night when he was scheduled to work beginning at midnight, because that was a date on which tickets were available.

"It was, moreover, accepted practice for meat inspectors to purchase meats, butcher knives, coats, and other equipment at establishments to which they were assigned, and at the same prices at which employees in the plants could purchase these items. There is no indication that this latter practice was considered a violation of the regulations. The record establishes that plaintiff received no discount or special treatment in the purchase of the tickets involved. * * *."

regional director, in a decision dated March 30, 1970, refused to disturb plaintiff's dismissal.[7] He did not think that there was sufficient support in the evidence to say that plaintiff either called the additional suspect meat to the attention of Merkel's officials or suggested that they remove it from the premises, but he nonetheless upheld the first charge against plaintiff because "it was incumbent upon appellant to place other Anselmo meat under restraint if he was suspicious in any way." He thus reasoned that plaintiff had failed to prevent removal of the suspect meat, as alleged in the second specification under the charge, although he did not explain why, on the evidence before him, plaintiff was or should have been "suspicious in any way." He also held that the second charge constituted a basis for dismissal, since in his opinion the manner in which plaintiff obtained the theatre tickets amounted to the acceptance of a favor in violation of regulations even though, as he concurred with the agency's examiner, plaintiff had paid for the tickets.

The Commission's Board of Appeals and Review affirmed the regional director's decision on August 17, 1970.[8]

[7] The regional director treated plaintiff's appeal on the March 18 through 30 leg of his suspension as untimely, since it was, in his view, an adverse action of less than 30 days and thus appealable only under the provisions of Civil Service regulations, Part 752-C, within 10 days. Plaintiff's appeal of the suspension did not occur until June 1, 1965, and so was out of time if governed by the cited regulation. We disagree with the director's opinion (concurred in by the Commission's Board of Appeals and Review) that the action taken against plaintiff was a temporary one only, for we think it clear that the suspension was indefinite in duration and was contemplated by both sides to be reimposed as soon as plaintiff's accumulated annual leave was exhausted. The director's technical distinction elevates form over substance, and we decline to follow it. *Tri-State Materials Corp.* v. *United States*, 213 Ct. Cl. 1, 11, 550 F. 2d 1, 7 (1977). Accordingly, plaintiff had no need to appeal the first leg of his suspension under Part 752–C, and we hold that the appeal that he later did press with regard to the March 18 through 30 period was timely.

[8] The affirmance contained one exception, not presently before us for review but worthy of note since it will affect the scope of the judgment here. Observing that the Commission's New York region had advised plaintiff back on July 16, 1965, that it was suspending action on his appeal "until the outcome of the proceedings resulting from the indictment was known or until the agency had completed its investigation surrounding the matter," the board observed that the "indictment against Mr. Erdwein was dropped on June 18, 1968; however, instead of restoring him to duty, the agency continued him in a non-pay status and on July 2, 1968 issued an advance notice of proposed removal * * *." As a result, the board found "that on June 18, 1968 the agency's conditions for termination of the indefinite suspension had been met; therefore, Mr. Erdwein was improperly suspended from June 19, 1968 through October 19, 1968." Plaintiff has been paid for this period.

Observing that while plaintiff's conduct in obtaining theatre tickets "might not, in and of itself, warrant removal," when it was considered in connection with the sustained portion of the first charge, namely, that "on December 11, 1964 Mr. Erdwein permitted Merkel, Inc., to ship out cartons of meat of the same type" that was under suspicion, "the Board comes to the inescapable conclusion that the agency's action in removing Mr. Erdwein was not arbitrary, capricious or unreasonable, but was taken for such cause as will promote the efficiency of the service." On July 27, 1971, after reviewing a memorandum submitted to it by plaintiff, the Civil Service Commission declined to reopen and reconsider any previous decision made in the case.

In brief summary, at the end of his very long and confusing travail, plaintiff found himself removed on the basis of charges bearing little resemblance to the charge used to launch his suspension, over 3½ years earlier. On the occasion of his first opportunity to plead his case before an "oral reply officer," that official declined to make even a recommendation on the original charge, because of lack of information. Instead, he relied on his own personal experience, not on a record, to sustain a newly surfaced second charge. This second charge was based on events alleged to have taken place about 4 years earlier. It was on the basis of the recommendation of the oral reply officer that plaintiff was removed effective October 19, 1968.

Plaintiff's second opportunity to defend against the charges, before a hearing examiner designated by the agency, resulted in erosion of the second charge which Dr. Diehl had found appealing. Mr. Perlman found that the agency had failed to sustain its burden of proving plaintiff did not pay for the tickets. He therefore declined to make any finding on that charge. But he made a finding on the first charge, concerning which Dr. Diehl had declined to make a recommendation. The reasoning underlying his finding is extremely weak, and is acknowledged by Perlman himself as not free from doubt.

As for the remainder of the suspension, the board concluded that it "was not arbitrary, capricious, or unreasonable and was for such cause as would promote the efficiency of the service."

As a result of the only Civil Service hearing, one provided by the New York regional office, the regional director eroded the first charge by finding, as he had to find, that there was insufficient credible evidence to support the first and more serious part of that charge. Then, although it would require the very same evidence which he had just rejected, in order to sustain the second part of that charge (namely, that plaintiff was aware by attendance at the meeting or otherwise of additional suspect meat, and later witnessed or was aware of its removal, but failed to prevent it, although he was not there at the time), the regional director saw fit to sustain that remnant of the first charge. That, coupled with the second charge (which he upheld), led him to the opinion that the agency decision to remove plaintiff was justified. Finally, the Board of Appeals and Review further retreated from positions previously taken. Although the board recognized that obtaining theatre tickets "might not in and of itself, warrant removal," it nevertheless concluded that this counseled removal when considered in connection with the sustained portion of the first charge.

The trial judge found that the portion of the first charge just referred to was not supported by any credible evidence, but only by speculation and conjecture. He further found that the second charge did not constitute a basis for removal.[9] Based on all the evidence, including the trial record, the trial judge concluded that the decision to remove plaintiff was arbitrary, capricious, and not supported by substantial evidence. *Giles* v. *United States*, 213 Ct. Cl. 602, 605, 553 F.2d 647, 649 (1977); *Urbina* v. *United States*, 209 Ct. Cl. 192, 530 F.2d 1387 (1976); *Ciambelli* v. *United States*, 198 Ct. Cl. 240 (1972); *Reil* v. *United States*, 197 Ct. Cl. 542, 456 F.2d 777 (1972). Upon our findings and conclusion, plaintiff is entitled to back pay for the period from his dismissal to the date of his death.

Plaintiff also asks us, as he asked the trial judge, to award him back pay for the time he was suspended from

[9] At most, he found, it was akin to the accepted practice of permitting inspectors to purchase meats, butcher knives, coats, and other equipment at establishments they were assigned to inspect, at the same prices available to plant employees. See note 6, *supra*.

duty pending the outcome of the indictment and the Agriculture Department's investigation.[10] The trial judge recognized that our holding in *Jankowitz* v. *United States*, 209 Ct. Cl. 489, 533 F.2d 538 (1976), raised a problem for plaintiff on this point, for it allowed an agency to impose an indefinite suspension without pay upon an employee under indictment, solely on the fact of the indictment, without incurring liability for back pay upon resolution of the criminal proceeding favorably to the employee. *Accord*, *Koontz* v. *United States*, 213 Ct. Cl. 762, *cert. denied*, 434 U.S. 984 (1977). This rule fits plaintiff's case exactly, so as to deny him entitlement to back pay for the period of his suspension, unless a further refinement of the holding in *Jankowitz* based on the special facts of this case would command otherwise. The trial judge would have us make that refinement, holding as he did that *Jankowitz* is subject to a rule of reason, so that a suspension without pay is not unjustified or unwarranted[11] if it is not imposed for longer than a *reasonable* period of time. He concluded that plaintiff was suspended for an unreasonably long period, for the agency could have completed its investigation and acted to remove him well before the dismissal of the indictment over 3 years after he was first suspended, and accordingly determined that plaintiff was entitled to back pay for the time he was suspended, less a reasonable period for the agency to conduct its investigation. The trial judge thought that 6 months was a reasonable time.

We see no need to travel the route that the trial judge has mapped out for us, nor to agree with plaintiff's counsel that back pay should be awarded for a suspension founded on an indictment that ultimately appears to have been totally without warrant. Rather, we hold that plaintiff is entitled to be paid for the full period of his suspension, simply because this is precisely what his agency promised him. As we noted above, his notice of suspension, March 16, 1965, reiterated by defendant on May 28, 1965, assured plaintiff that "pay otherwise due you will be restored" if neither the criminal proceedings against him nor the

[10] Other than the time when he was restored to duty to allow exhaustion of his accrued leave. See note 2, *supra*.

[11] Within the meaning of the Back Pay Act of 1966, 5 U.S.C. § 5596(b) (1970).

Department's own investigation disclosed "misconduct on your part which would warrant serious disciplinary action." Obviously, the criminal proceedings disclosed no such misconduct, for the indictment was dismissed on motion of the state.

Likewise, the Department's investigation, the fruits of which were displayed in the administrative hearings and the trial in this court, yielded no credible evidence of wrongdoing or violations of regulations on plaintiff's part that could fairly lead to the imposition of serious disciplinary action. As thoroughly shown in the facts we have previously set forth in considerable detail, plaintiff's agency possessed, from its investigation and otherwise, no hard evidence that plaintiff was present at the Merkel employees' meeting, knew about it contemporaneously, had knowledge or counseled removal of other suspect meat, knowingly or even negligently permitted the removal of meat that did occur, or ever accepted anything of value from Merkel that constituted a favor in violation of regulations, whether or not in connection with the meat removal. Defendant has not excepted to any of the trial judge's findings on the foregoing. We therefore take it as established that the agency had no basis in fact or law upon which to proceed against plaintiff in the manner that it did in mid-July 1968.

There having been no disclosure of serious misconduct on plaintiff's part, the agency's assurance that "pay otherwise due you will be restored" must be honored. We read the letter of suspension to have imposed a suspension without pay which had a condition attached to it. The condition was that the suspension would remain payless if and only if either the criminal proceedings or the agency's investigation produced proof of misconduct. Since neither ultimately yielded such proof, according to the letter's own terms, the suspension must retroactively be treated as one with pay. The condition of nonpayment was not fulfilled, and so, the pay otherwise due to plaintiff for the period of his suspension must be restored to him. Thus, plaintiff's award of back pay is held to include the pay he would have received while suspended from duty, had he been suspended with pay. This result, based on the assurances

given plaintiff in defendant's letters imposing his suspension, grants plaintiff all the monetary relief he requested, and actually exceeds the back pay he would have been awarded had we followed the trial judge's approach.

In view of the foregoing disposition of the case, it is unnecessary for us to reach plaintiff's assertion of various procedural errors. *Cruz-Casado* v. *United States*, 213 Ct. Cl., 498, 502, 505, 553 F.2d 672, 675, 676 (1977). For the reasons given in the opinion and the findings therein, the court concludes as a matter of law that plaintiff is entitled to back pay for the heretofore unpaid period of his suspension, March 18 through March 30, 1965, and June 5, 1965, through June 18, 1968,[12] and for the period from the date of his removal, October 19, 1968, to the date of his death, January 27, 1976. The amount of the recovery and the appropriate collateral relief to which plaintiff is entitled, subject to such offsets, if any, as are applicable, will be determined in further proceedings in accordance with Court of Claims Rules 131(c) and 147(c), respectively.

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564 F.2d 939

GEORGE HYMAN CONSTRUCTION COMPANY v. THE UNITED STATES

[No. 61-76. Decided October 19, 1977]

ON DEFENDANT'S AND PLAINTIFF'S CROSS-MOTIONS FOR SUMMARY JUDGMENT

Contracts; interpretation; ambiguity; contract considered as a whole.—Plaintiff entered into a contract with General Services Administration for construction of Phase I of the United States Tax Court building. Plaintiff seeks Wunderlich Act review of a decision of the Board of Contract Appeals denying an equitable adjustment for the connection of underground utility lines shown on the "Site Utility Plan" drawing 9-OS-1 to existing lines of the same kind located outside the foundation walls of the building and to a neighboring building, as ordered by the contracting officer. Plaintiff contends that the contract only required it to "stub-out" the utility lines a distance of five feet from the Tax Court building as shown on the "Basement Floor Plan—

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[12] See note 8, *supra*.

Syllabus

Plumbing" drawing 9–P–1, that the work of installing the lines to connect with existing lines was the obligation of the Phase II contractor, and that the construction constituted a constructive change order. In approving the decision of the board, the court *holds* (1) that the two drawings do not conflict but are complementary, drawing 9–P–1 requiring plaintiff to extend the utility lines five feet from the building, and drawing 9–OS–1 requiring plaintiff to extend and connect the lines to existing lines of like character outside the Tax Court building, notwithstanding plaintiff's claim that trade practice requires extending the lines only five feet; and (2) that the directive of the contracting officer was not a constructive change order. Defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied, and the petition is dismissed.

Contracts; disputes; administrative decision; finality of on question of law.

[1] Interpretation of a contract is a question of law for the court to decide and an administrative interpretation thereof is not binding on the court, although such interpretation will be given careful consideration and accorded great respect.

United States ⚖70(3)

Contracts; interpretation; contract as a whole; clauses construed together.

[2] The "contra proferentem" rule that if the language of contract specifications is ambiguous and the contractor's interpretation is reasonable, the ambiguity will be construed against the Government as drafter of the contract is inapplicable where the contract, considered as a whole, including the specifications and drawings, is clear and unambiguous.

United States ⚖70(3)

Contracts; interpretation; clarification, necessity for seeking.

[3] Where the ambiguity in a Government-drafted contract is patent, the contractor is obligated to make inquiry prior to bidding of the contracting officer as to the meaning of the ambiguous discrepancy. Failure to make such an inquiry forecloses a contractor's later attempt to invoke the ambiguity rule.

United States ⚖64

Contracts; interpretation; trade usage or practice.

[4] Trade practice cannot prevail over unambiguous provisions of a Government contract.

United States ⚖70(2)

Matthew S. Perlman, attorney of record for plaintiff. *William W. Goodrich, Jr.* and *Arent, Fox, Kintner, Plotkin & Kahn,* of counsel.

Lawrence S. Smith, with whom was *Assistant Attorney General Barbara A. Babcock,* for defendant.

Before DAVIS, *Judge,* SKELTON, *Senior Judge,* and NICHOLS, *Judge.*

SKELTON, *Senior Judge,* delivered the opinion of the court:

The plaintiff, George Hyman Construction Company (contractor or plaintiff), entered into contract No. GS–00B–01214 on June 30, 1972, as contractor with the General Services Administration of the United States Government (the Government or defendant), for the construction of Phase I of the United States Tax Court Building in Washington, D.C., for the sum of $13,228,000. During construction a dispute arose between the contractor and the Government with reference to the construction of eight utility lines, namely the storm and sanitary sewer, water service, steam and condensate return lines, which are shown on drawing No. 9–0S–1, designated "Site Utility Plan." These lines ran underground to existing lines of the same kind, two of which ran to the wall of the Labor Department Building, all of which are shown on the above drawing. The contractor took the position that it was only required to "stub-out" the utility lines a distance of five feet from the building as shown on drawing 9–P–1, designated "Basement Floor Plan-Plumbing," and was not required to construct and install the utility lines to the existing lines of the same kind outside the building, two of which entered the nearby Labor Department Building. The Government contended that the contractor was required by the contract to construct the utility lines to the existing lines and to the Labor Department Building, as aforesaid. The contracting officer ordered the contractor to so construct the lines, which it did, but it claimed this was a constructive change order not covered by the contract and that it was entitled to an equitable adjustment. It filed a claim to that effect with the contracting officer, who denied the claim. The contractor appealed to the GSA Board of Contract Appeals (Board), which heard the appeal and

denied the contractor's claim in GSBCA–3722 on January 23, 1974, 74–1 BCA ¶ 10,451, with one member of the Board dissenting. The contractor has appealed from the Board's decision to this court under the Wunderlich Act, 41 U.S.C. §§ 321, 322, claiming that the decision of the Board is arbitrary, capricious, unsupported by substantial evidence, and is erroneous as a matter of law. The Government says that the decision of the Board is correct and should be affirmed. The case is before the court on cross-motions for summary judgment. We have concluded that the law and the facts do not support the contractor's claim, and we hold for the Government.

The facts show that in the beginning the Government intended to construct the Tax Court Building under one contract, but before issuing the invitation for bids, the plan was changed so as to have the building constructed by two contracts designated "Phase I" and "Phase II." When the plaintiff noticed these designations on the drawings, it made inquiry on June 9, 1972, of the GSA as to their meaning. The GSA responded by amending the special conditions of the contract on June 13, 1972, by adding to section 0110 a new paragraph 1.2 immediately after paragraph 1.1 as follows:

> 1.2 A separate contract designated as Phase II will be awarded to complete the United States Tax Court Building project. The Contractor for Phase I construction shall provide access to the site for the Phase II Contractor without additional cost to the Government or charge to the Phase II Contractor. He shall cooperate with the Phase II Contractor and with the contractor for subway construction to coordinate and execute the work properly.

On June 20, 1972, amendment No. 4 to the invitation for bids was added to new paragraph 1.2 as follows:

> Any reference to Phase I means contract requirements of GS–00B–01214.

Being satisfied with the reply of the GSA, the contractor submitted its bid and was awarded the contract (No. GS–00B–01214) on June 30, 1972, after which it began construction.

As stated above, during construction the contracting officer ordered the contractor to install the eight utility lines above-described and connect them with existing lines of the same kind which were located outside the foundation walls of the Tax Court Building. The contractor took the position that it was only required to "stub-out" the utility lines five feet from the building as shown by drawing No. 9–P–1. It contended further that architectural drawing 2–1 and other architectural drawings contained notations such as "Limit Phase I Construction @ Face of Building" and other notations of like import, and the contractor argued that these drawings indicated that it was only required to do the work of Phase I within the confines of the four walls of the building and any work outside of the building was to be performed by the contractor who was to work on Phase II of the building. Consequently, the contractor contended that it had no duty or obligation to construct and install the utility lines in question so that they would connect with existing lines outside of the building, and that such work was to be done by the Phase II contractor. The contracting officer disagreed and required the contractor to connect the utility lines with those existing outside the building. The contractor appealed from the decision of the contracting officer and exhausted its administrative remedy when it received an adverse decision from the Board, and the case is now before us for review under the provisions of the Wunderlich Act.

The contractor makes an ingenious argument, but the controlling facts do not support its position. The contract specifications and drawings make it abundantly clear that the contract required the contractor to install the utility lines so that they would connect with existing lines outside of the Tax Court Building.

Specifications section 0110, "Special Conditions," clause 1, "General," paragraph 1.1 provides in full:

> 1.1 Requirements of the contract include furnishing all labor and materials and performing all work for construction of United States Tax Court Building, Second Street Northwest between D & D Streets [sic], Washington, D. C., including all changes and repairs incident thereto, as specified and as shown on Drawings No. 0–1,

1–1 through 1–4, 2–1, 2–2, 3–1 through 3–7, 4–1 through 4–5, 5–1 through 5–25, 7–1 through 7–15, 9–0S–1, 9–ME–1, 9–ACH–1 through 9–ACH–15, 9–P–1 through 9–P–10, 9–E–1 through 9–E–22 (all numbers inclusive) and the listed Standard Details and noted modification thereto.

This section of the specifications is crucial to a decision of this case. It will be noted that the contractor is required to furnish all labor and materials and to perform all work as specified and shown on drawings "9–0S–1" and "9–P–1" and the other enumerated drawings. The contractor relies on drawing 9–P–1, which is the basement floor plan that shows the utility lines extending five feet from the sides of the building. The Government relies mainly on drawing 9–0S–1, which is the site utility plan that shows in great detail the required construction of the utility lines so that they connect with existing utility lines of the same kind, two of which enter the nearby Labor Department Building. A reduced copy of the relevant and pertinent parts of drawing 9–0S–1 is attached to the end of this opinion as an appendix.

It will be observed, and we conclude, that drawings 9–P–1 and 9–0S–1 do not conflict and neither drawing contradicts or is inconsistent with the other. In fact, they could be said to be complementary. The contractor was required to furnish the labor and material and perform the work specified on *both* drawings. Drawing 9–P–1 required it to extend the utility lines five feet from the building, and drawing 9–0S–1 required it to extend and connect the utility lines to existing lines of like character outside of the Tax Court Building.

The argument of the contractor that the work of installing the utility lines so that they would connect with existing lines was the obligation of the Phase II contractor is refuted by section 0110 of the specifications quoted above that requires plaintiff to comply with drawing 9–0S–1, which drawing has printed thereon in bold letters the following:

CONTR. NO. GS–00B–01214

This is the contract involved here. Therefore, the installation of the utility lines called for in that drawing was a part of the present contract and required perform-

ance by the plaintiff and not by some future contractor of Phase II.

The contractor's argument that it was only required to do the work within the four walls of the building because of the notation on some of the drawings that stated "limit Phase I construction at the face of the building," and other similar notations, is refuted by the fact that drawing 9–0S–1 does not contain any such notation, and, in fact, does not even mention Phase I or Phase II. Furthermore, section 1501, clause 11, paragraph 11.1 provides specifically that any "limit of contract" lines or similar general limits that may appear on the site or other drawings shall not be deemed to apply to the mechanical work on utility lines between building and points of connection. The provisions of this part of section 1501 are as follows:

1. APPLICABILITY

1.1 This section applies to all mechanical and electrical work, including materials and equipment, and is subject to the requirements of the "General Provisions," "General Conditions," and "Special Conditions" sections of this specification.

* * * * *

11. OUTSIDE SERVICES

11.1 Underground and overhead mechanical and electrical services shall be provided complete to and between building and points of connection to utility lines, etc., as shown on drawings and specified under other sections of this specification. Any "Limit of Contract" lines or similar general limits that may appear on site or other drawings shall not be deemed to apply to the foregoing mechanical and electrical work.

It is clear that this section of the contract provided an exception to the "limit of contract lines to the face of the building" relied on by the contractor and required it to construct the utility lines to points of connection with existing lines outside the four walls of the building.

There are a number of other provisions of the contract that persuade us to conclude that the contractor was required to construct the utility lines so as to connect with existing lines outside of the building, and that its work was not confined to the area inside the four walls of the

structure. For instance, paragraph 2 of the "General Provisions," form 23–A, provides in pertinent part, as follows:

> Anything mentioned in the specifications and not shown on the drawings, or shown on the drawings and not mentioned in the specifications, shall be of like effect as if shown or mentioned in both. In case of difference between drawings and specifications, the specifications shall govern.

This paragraph obviously makes the work shown on drawing 9–0S–1 required work, irrespective of plaintiff's interpretation of the specifications.

Paragraph 20.b. of section 1564 provides as follows:

> b. Excavate trenches of sufficient width for proper installation of conduit systems and grade bottom of trenches evenly so the conduit will have a solid bearing for full extent of the conduit installation. Excavate rock to a uniform grade 3 inches below conduit. Refill all cut below trench grade with sand firmly compacted.

This paragraph indicates that the contractor should install the conduit systems, because it would not have been practical nor logical for it to excavate the trenches and prepare them for the conduits if some other contractor was to install them.

Paragraph 22 of section 1564 describes and provides for manholes that are located outside the building. The construction and location of these manholes are shown in detail on drawing 9–0S–1 which, as set forth above, was a part of plaintiff's contract. This drawing shows the steam and condensate lines going through the manholes. All of this work was clearly the obligation of the plaintiff and not that of some future contractor.

Paragraph 32 of section 1564 provides that "cathodic protection shall be provided for the steel conduit systems furnished under this specification." A note on drawing 9–0S–1 states in part: "provide cathodic protection * * * see specifications." There would not have been any need to require the plaintiff to provide cathodic protection for steel pipes unless he was to install them. If the pipes were not there and were to be put in place later on by a future contractor, the above requirement would have been use-

less, as the plaintiff could not provide this protection to pipes he did not have.

Section 1570 is captioned "Heating Apparatus." Paragraph 1.1 provides that this section of the specification "includes the installation of a complete steam distribution and hot water heating system for the building as described herein and indicated on the drawings, and is subject to the requirements of the 'Mechanical and Electrical Equipment, General Requirements' section of this specification." The contractor obviously could not install complete systems if there were no underground steam pipes and water pipes running to the existing underground supply pipes supplying the steam and water, as shown on drawing 9–0S–1.

Section 1517 is entitled "Plumbing." Paragraph 1 provides that this section of the specification "includes the furnishing and installation of complete drainage, water supply and fire protection systems, etc., as described herein and indicated on the drawings, and is subject to the requirements of the 'Mechanical and Electrical Equipment, General Requirements' section of this specification."

Paragraph 5.1 provides that connections to street sewers shall be in accordance with local regulations. Paragraph 6.1 provides that sanitary and storm drain lines outside the lot lines shall be constructed in accordance with local regulations. Paragraph 16 relates to water piping and paragraph 16.1 provides that, outside the lot lines, the piping shall be in accordance with the local water authority regulations.

These paragraphs of section 1517 show clearly that work was required outside of and beyond the face of the Tax Court Building, that plaintiff was required to furnish the underground utilities involved herein. For example, paragraph 5.1 refers to connections to street sewers; such sewers are shown on drawing 9–OS–1 and plaintiff clearly was required to carry the pipes to those sewers. Its position that its work stopped at the face of the building, with the piping extending only five feet, is without support in the facts.

Paragraph 31.1 of the "Special Conditions" provides that the contractor shall "obtain all necessary permits in public space for the construction of utility lines." It would be

extremely unusual and illogical to require the contractor under this contract to obtain permits for the construction of utility lines to be installed by some other contractor unknown to it. Yet, this results from the position the plaintiff asserts in this suit.

Paragraph 38 of section 0110 is captioned "Survey of Outside Utility Lines." Paragraph 38.1 provides, in pertinent part, as follows:

> 38.1 Upon completion of the building, the Contractor shall furnish to the Contracting Officer for approval an acceptable and accurately dimensioned survey showing the location and elevation of all utility lines (water, gas, electric, sewer, steam, etc.) including valves, connections and changes in direction, as installed under the contract, within the property lines and outside the building walls * * *. Points where utility lines leave the property shall be located from lot monuments.

It would not be logical to require the contractor to furnish a survey showing location and elevation of utility lines about which it knew nothing and for which it had no responsibility (*i.e.*, which, according to plaintiff, were to be furnished under another contract by a contractor unknown to plaintiff).

Paragraph 42 of section 0110 is entitled "Work Outside of Property Lines." Paragraph 42.1 states as follows:

> 42.1 Work outside of property lines, including repair, replacing and furnishing of streets, sidewalks, gutters and curbs cut in performance of underground work, is to be done in accordance with applicable codes and/or ordinances.

It would be illogical for the specifications to provide, as here, that work outside the property line (which is more than five feet from the walls of the building), and specifically "underground work," is to be done in accordance with certain codes if under the contract the contractor had no such work to perform.

We conclude from these contract provisions and drawings that the plaintiff was required to install the eight underground utility lines involved here and to connect them with existing lines of the same kind outside the walls of the Tax Court Building, as shown on drawing 9–OS–1.

The plaintiff contends that an ambiguity exists in the specifications and drawings and that its interpretation of their meaning is reasonable. Under these circumstances, the plaintiff invokes the doctrine of *contra proferentem*, which requires the ambiguity to be resolved against the drafter of the contract (the Government here), citing *WPC Enterprises, Inc.* v. *United States*, 163 Ct. Cl. 1, 323 F.2d 874 (1963). We reject this argument for several reasons. The interpretation of a contract is a question of law for the court to decide and an administrative interpretation of a contract is not binding on the court. *See Merando, Inc.* v. *United States*, 201 Ct. Cl. 19, 21, 475 F.2d 598, 599 (1973); *Tri-Cor, Inc.* v. *United States*, 198 Ct. Cl. 187, 204, 458 F.2d 112, 122 (1972); *Martin Lane Co.* v. *United States*, 193 Ct. Cl. 203, 206–07, 432 F.2d 1013, 1014–15 (1970); *Mountain Home Contractors* v. *United States*, 192 Ct. Cl. 16, 23, 425 F.2d 1260, 1264 (1970). However, a Board's interpretation of a contract will be given careful consideration and accorded great respect. *See Dale Ingram, Inc.* v. *United States*, 201 Ct. Cl. 56, 475 F.2d 1177 (1973); and *Winston Brothers Co.* v. *United States*, 198 Ct. Cl. 37, 458 F.2d 49 (1972). That has been done in this case. The Board's interpretation of the contract was correct and we approve it.

The rule relied on here by the plaintiff that if there is an ambiguity in the contract, and the interpretation of both parties is reasonable, the court will construe and resolve the ambiguity against the drafter of the contract, is not applicable in this case. We interpret the contract, when considered as a whole, including the specifications and drawings, to be clear and unambiguous. Under these circumstances, the plaintiff's interpretation of the contract is unreasonable. Furthermore, if plaintiff's interpretation is carefully analyzed, it is apparent that the presently claimed ambiguity arises from its argument that drawing No. 9–P–1 and other architectural drawings are in direct conflict with drawing No. 9–OS–1 and the various specifications and contract provisions discussed in detail above. Had the plaintiff believed this to be so before it submitted its bid, the alleged ambiguity would have been a patent one which imposed a duty on the plaintiff to make inquiry of

the contracting officer before it submitted its bid as to the meaning of the ambiguous discrepancies. This is a well established rule. *See Merando, Inc.* v. *United States, supra; Space Corp.* v. *United States,* 200 Ct. Cl. 1, 5, 470 F.2d 536, 538 (1972); *Bishop Engineering Co.* v. *United States,* 180 Ct. Cl. 411, 415 (1967); *Blount Brothers Construction Co.* v. *United States,* 171 Ct. Cl. 478, 496, 346 F2d. 962, 972–73 (1965); and the cases cited in the foregoing cases. The plaintiff made no such inquiry and in no way called to the attention of the contracting officer the discrepancies and conflicts it is now claiming before it submitted its bid. The general inquiry as to the meaning of the terms "Phase I" and "Phase II' on the drawings it made to the contracting officer in its letter of June 9, 1972, was not a sufficient inquiry as to the alleged discrepancies and conflicts it is now claiming and which it asserted for the first time after it was awarded the contract and had started construction. The failure of the plaintiff to make such an inquiry forecloses its attempt to invoke the ambiguity rule now.

We hold that the directive of the contracting officer of September 19, 1972, ordering the plaintiff to install the utility lines in question and connect them with existing lines of the same kind outside the walls of the Tax Court Building was not a constructive change order and the plaintiff is not entitled to an equitable adjustment by reason thereof.

The plaintiff says that it is the practice of the trade in the construction industry for contractors to install five-foot exterior utility line connections at the face of a building, and that this practice in the trade supports its position here. We do not agree. A trade practice cannot prevail over unambiguous provisions of a contract such as we have in the instant case. The question is what is required under the terms of the contract. *See Merando, Inc.* v. *United States,* 201 Ct. Cl. 28, 31, 475 F.2d 603, 604 (1973); and S. S. *Silberblatt, Inc.* v. *United States,* 193 Ct. Cl. 269, 288, 433 F.2d 1314, 1323–24 (1970), and cases cited. The trade practice theory is of no help to the plaintiff in this case.

We hold further that the decision of the Board is neither arbitrary nor capricious and is supported by substantial evidence and is entitled to finality under the provisions of

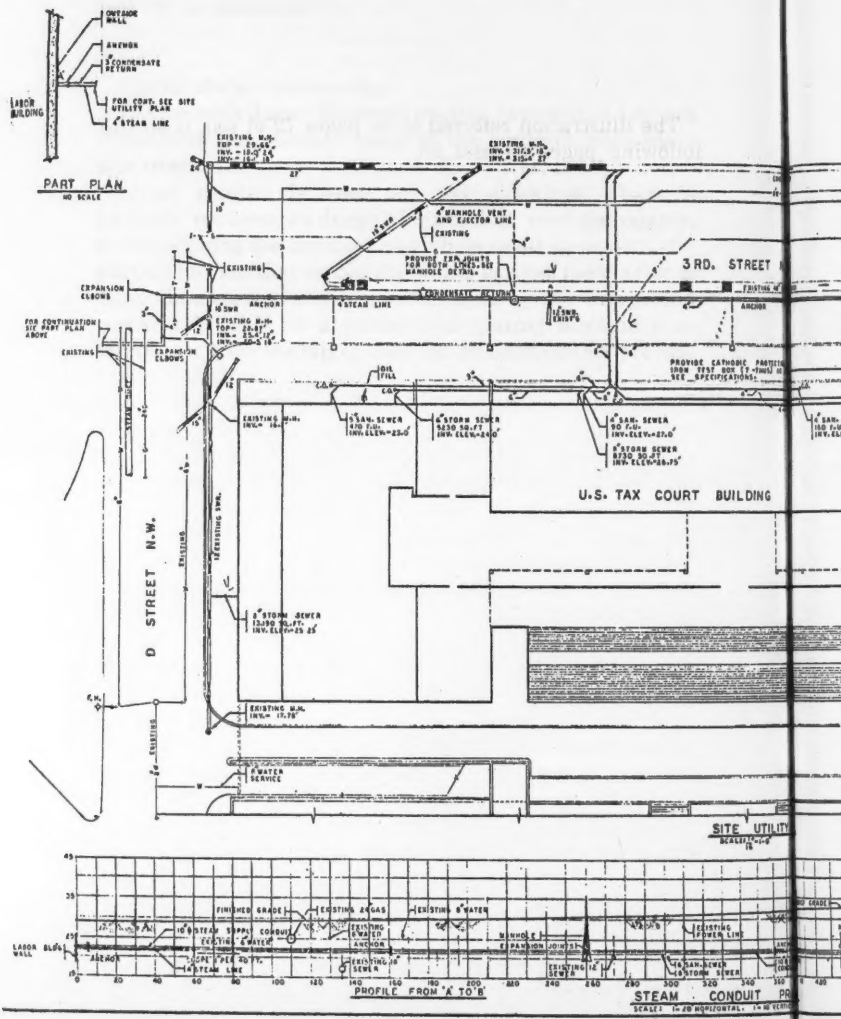
the Wunderlich Act. We find no error of law in the decision of the Board and it is approved.

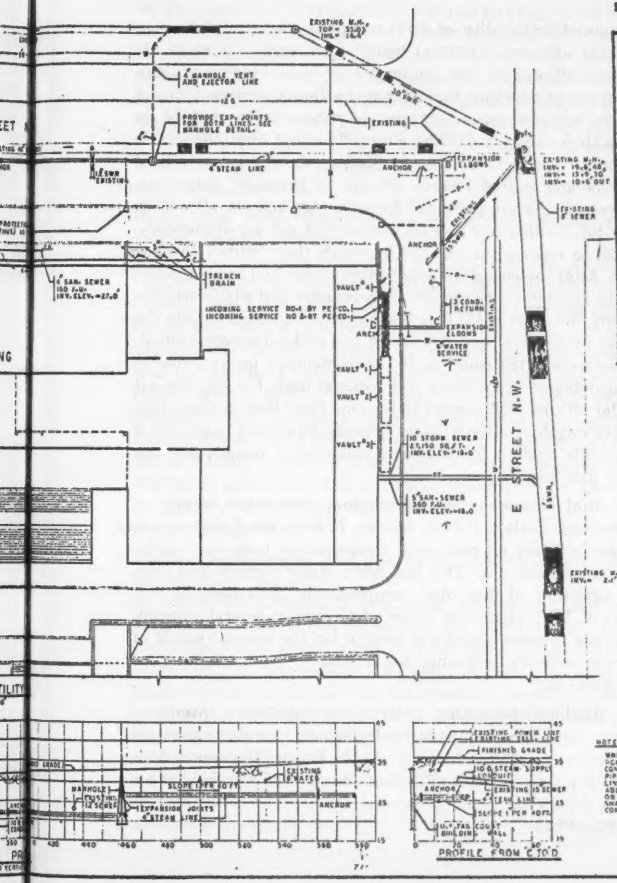
The defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied, and plaintiff's petition is dismissed.

DAVIS, *Judge*, concurring:

I agree with Judge Skelton's opinion except that I do not think that the relevant parts of the contract were plain and unambiguous on their face. There was, in my view, a surficial conflict between the two drawings which is properly resolved, as Judge Skelton does very thoroughly, by considering the contract as a whole in all its aspects and parts. The rule that ambiguity works against the drafter is more than neutralized in this instance by the companion canon applicable to a patent and glaring ambiguity or discrepancy. On the whole case the plaintiff cannot prevail.

The illustration referred to on pages 72 et seq. is on the following pages 84 and 85.


OUTSIDE WALL
ANCHOR
CONDENSATE RETURN
FOR CONT. SEE SITE UTILITY PLAN
STEAM LINE
LABOR BUILDING
PART PLAN
NO SCALE
EXISTING W.M.
4" MANHOLE VENT AND EJECTOR LINE
EXISTING
PROVIDE EXP. JOINTS FOR BOTH LINES-SEE MANHOLE DETAIL
3 RD. STREET
EXPANSION ELBOWS
ANCHOR
CONDENSATE RETURN
4" SWR
EXISTING M.H.
FOR CONTINUATION SEE PART PLAN ABOVE
EXISTING
EXPANSION ELBOWS
STEAM LINE
EXISTING M.H.
6" SAN. SEWER
6" STORM SEWER
6" SAN. SEWER
6" STORM SEWER
U.S. TAX COURT BUILDING
D STREET N.W.
EXISTING SWR.
EXISTING
8" STORM SEWER
EXISTING M.H.
C.H.
4" WATER SERVICE
SITE UTILITY
FINISHED GRADE
EXISTING 6" GAS
EXISTING 6" WATER
10"ø STEAM SUPPLY CONDUIT
EXISTING 6" WATER
EXISTING 6" WATER ANCHOR
MANHOLE
EXPANSION JOINTS
EXISTING POWER LINE
LABOR BLDG.
ANCHOR
CPE
PED
EQ TY.
STEAM LINE
EXISTING 10" SEWER
EXISTING 12" SEWER
6" SAN. SEWER
6" STORM SEWER
PROFILE FROM 'A' TO 'B'
STEAM CONDUIT



NOTE!

WHERE CONFLICTS OCCUR BETWEEN THE ROUTING OF NEW STEAM AND PUMPED CONDENSATE LINES AND EXISTING CONDUIT RUNS, THE NEW STEAM AND CONDENSATE LINES SHALL BE ADJUSTED TO MAINTAIN ABSOLUTE CLEARANCE. ELEVATIONS SHOWN ON PROFILE ARE APPROX. ONLY. AND CONTRACTOR SHALL VERIFY LOCATION OF ALL PIPING AND CONDUIT BEFORE EXCAVATION BEGINS.

CONTR. NO.	GS-00B-01214
DRAWING TITLE	SITE UTILITY PLAN
	MECHANICAL & ELECTRCAL
DRAWING NUMBER	9-OS-1

5 APRIL 72

564 F.2d 403

LT. COL. VINCENT PUGLISI, ET AL. v. THE UNITED STATES

[Nos. 275–76 through 281–76, 386–76 through 388–76.
Decided October 19, 1977]

ON DEFENDANT'S MOTION TO DISMISS AND PLAINTIFFS' CROSS-MOTION FOR SUMMARY JUDGMENT

Military pay; constitutionality of dual compensation restriction re retired regular officers; "rational basis" standard.—Plaintiffs are retired regular officers of the uniformed services holding civilian Federal Government positions. Pursuant to the Dual Compensation Act of 1964, their military retirement pay is substantially reduced in accordance with 5 U.S.C. § 5532(b). Plaintiffs assert that the Act is unconstitutional, especially because it distinguishes between retired regular officers and retired reserve officers to plaintiffs' detriment. Retired reserve officers are exempted from the Act and are allowed to receive their full civilian pay and full retirement pay simultaneously. Plaintiffs seek to recover the amount by which their retired pay has been reduced. After reviewing the long history of the dual compensation legislation, the regulations promulgated thereunder and administrative interpretations, the court *holds* that the restriction does not violate the Constitutional prohibition against a direct tax without apportionment; nor does it contravene the equal protection component incorporated in the Fifth Amendment, since there is a rational basis for singling out retired regular officers with respect to limiting their federal compensation and restricting dual office-holding. Defendant's motion to dismiss is granted, plaintiffs' motion for summary judgment is denied, and the petitions are dismissed.

Civilian pay; dual compensation restriction; legislative intent. [1] One of the basic goals of Pub. L. 88–448, 78 Stat. 484 (1964), was to consolidate and simplify all prior dual compensation laws and regulations in one manageable law. This law had a wider purpose and form than mere updating of the dual compensation provisions of the Economy Act of 1932 which was designed to restrict federal expenditures to alleviate to some extent the need to tax the general public in order to bring revenues back into the Treasury.

Armed Services ⚖13.5(11)

Civilian pay; dual compensation restriction; legislative intent. [2] The history of the dual compensation legislation indicates a policy to limit dual opportunities to receive pay from the Federal Government—a qualification upon federal employment and compensation rather than a tax, direct or otherwise.

Armed Services ⚖13.5(11)

Syllabus

Constitutional law; direct tax without apportionment prohibition; dual compensation restriction; retired military officers.

[3] A tax in legal contemplation is an exaction, taking money from the taxpayer for public purposes, an enforced proportional contribution of money or other property. The Economy Act of 1932 did not take from retired officers money or property to which they were entitled. It simply closed off to them partially, federal civilian pay which Congress felt they should not also have.

Armed Services ⚖13.5(11)

Constitutional law; equal protection of the law; classification; dual compensation restriction.

[4] The validity of the classification drawn by Congress in the 1964 dual compensation statute must be examined under the "rational basis" standard—whether it is rationally related both to a legitimate governmental interest and to the objective of the particular legislation. An obvious purpose of the statute is, in general, to put a ceiling on the amount of compensation certain classes of individuals can receive from the Federal Government—a function historically and constitutionally within the power of Congress.

Armed Services ⚖13.5(11)

Military pay; dual compensation restriction; retired regular and retired reserve officers.

[5] The more lenient treatment of retired reserve officers v. retired regular officers for dual compensation purposes can be justified (1) because under military regulations regular officers can normally serve longer and receive significantly higher retirement pay than reserve officers, and, therefore, under the dual compensation restriction the total compensation received by those retired regular officers and retired reserve officers holding civilian federal jobs is more in parity; and (2) because of the difference between the offices they hold—a retired regular officer continues at all times to hold an office in the military and is already a federal officeholder, a retired reserve officer can be ordered to active duty only in time of war or national emergency after all active reservists have been called.

Armed Services ⚖13.5(11)

Statutes; construction and operation; judicial interpretation; "rational basis" standard.

[6] Where the standard in evaluating the constitutional validity of a congressional rule which an agency may deem unjust as a matter of good employment policy is the "rational basis" gauge, the court cannot strike down the rule because it believes Congress erred or made a wrong policy decision or even because the result seems unfair in some general sense. If the distinction embodied in the law is reasonably related to a legitimate governmental interest which Congress seeks to advance, the court must uphold the rule although it may seem unwise or that a more just system could clearly be devised. The opposed views of public policy are considerations for the legislative choice.

Constitutional Law ⚖47

Military pay; dual compensation restriction; retired regular and retired reserve officers.

[7] Congress has the authority to choose the restrictions included in its legislation, and this court cannot impose its own judgment, or that of others within the Government, if there is any reasonable basis for what Congress has done. Since there is a rational basis for singling out retired regular officers with respect to dual compensation restriction, the court cannot deny to Congress the right to its own judgment to make that distinction. To remove the possible inequities, resort to Congress, not to the courts, is appropriate.

Armed Services ⚖13.5(11)

Civilian pay; dual compensation restriction; exceptions.

[8] The exception of 5 U.S.C. § 5532(d) for "special or emergency employment needs which otherwise cannot be readily met" to the dual compensation restriction has rationality, and Congress cannot be faulted for permitting leeway in the face of such necessity.

Armed Services ⚖13.5(11)

Military pay; dual compensation restriction; retired regular and retired reserve officers.

[9] Since the Dual Compensation Act of 1964 declares that the retired pay of a regular officer "shall be reduced" to further the purpose of limiting the over-all compensation paid to such officers by the Government, deferment of the withheld portion of the officer's retired pay would nullify that purpose.

Armed Services ⚖13.5(11)

John A. Everhard, attorney of record, for plaintiffs. *Thomas H. King,* of counsel.

Richard J. Webber, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, NICHOLS and KASHIWA, *Judges.*

DAVIS, *Judge,* delivered the opinion of the court:

Plaintiffs are retired regular officers of various components of the uniformed services who hold civilian positions with the federal government. As retired regular officers they are permitted to receive their full civilian pay but, pursuant to the Dual Compensation Act of 1964, now 5 U.S.C. § 5532(b) (1970), their retirement pay is substantially reduced.[1] Retired reserve officers, on the other hand,

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[1] 5 U.S.C. § 5532(b) provides generally that a retired regular officer may receive full civilian pay but his retirement pay shall be reduced to an annual rate equal to the first $2,000 of retirement pay plus one-half of any remainder. Certain exceptions

are exempted from the Dual Compensation Act and therefore allowed to receive their full civilian pay and full retirement pay simultaneously. 5 U.S.C. § 5534. In this suit for the amount of retirement pay withheld from them, claimants assert that the Act is unconstitutional, especially because it distinguishes between retired regular officers and retired reserve officers to the detriment of the former group. Defendant has moved to dismiss the petitions and plaintiffs have cross-moved for summary judgment. Only legal issues are raised, and the case is ready for disposition.

A.

Before we consider the arguments pro and con, we set forth a brief summary of the long history of the federal government's dual compensation legislation. The various forms of those laws date back to 1839. *See* 9 OP. ATT'Y GEN. 123 (1857) and 9 OP. ATT'Y GEN. 507 (1860); Sharp, *Dual Compensation and Employment Study,* American Law Division, Library of Congress, *109* Cong. Rec. 9546 (1963). The Supreme Court held that the primary purpose of the earlier provisions was to prevent a person holding a job setting definite compensation from receiving extra pay for additional services which might and should have become part of his regular duties. *See, United States v. Saunders,* 120 U.S. 126, 129 (1887). The Court there ruled that under the then prevailing law it was proper for someone to perform two distinct jobs concurrently and receive the salary for each; it was the Court's opinion, however, that the then-existing legislation prevented an officeholder adding on to his salary payments for "extra" duties which may not have been clearly designated in his original job description.

The next important dual compensation provision appeared in the Dual Office Act of 1894, ch. 174, § 2, 28 Stat. 162, 205, which the defendant sees as the forerunner of the 1964 Act with which we are now concerned. This 1894 statute declared that no one holding an office which paid $2,500 or more could be appointed to any other office to which compensation was attached. A retired officer of the

and exemptions are provided for in § 5532(c) and (d). *See infra.*

regular armed forces was deemed an officeholder within the 1894 Act.[2] According to a modern-day observer, one reason for the 1894 law was to prevent abuse by officers using their military positions to obtain lucrative civil service jobs upon retirement.[3] If that intent can be ascribed to the 1894 Congress, then the Act, at least in large measure, was a "dual office" act designed to prohibit the holding of more than one high federal office. As we judge it, however, the purpose of the 1894 Act was more than that—not only to prevent those abuses but also to limit the total compensation receivable by any one person from the Government. The 1894 Act, although called the Dual Office Act, did not expressly prohibit dual officeholding (by retired military officers or others) *qua* officeholding. Instead, the Act set dollar limits on total salary. Under it a retired regular officer receiving retirement pay of $2,500 or more could not hold any other paid federal office. But according to H.R. REP. No. 890, 88th Cong., 1st Sess., p. 4 (Nov. 7, 1963), the 1894 Act, when passed, did not prevent many retired regular officers from holding dual office because retirement allowances and federal civilian salaries were most often less than $2,500 each. As time went on and compensation rose, the prohibition bit deeper.[4] The next significant dual compensation provision, relevant here, was part of the Economy Act of 1932, Ch. 314, § 212, 47 Stat. 382, 406, which plaintiffs stress (it is discussed more fully, *infra*). This measure allowed a $3,000 maximum total federal compensation for retired officers holding civilian government jobs (an amount raised to $10,000 by amendment in 1955 (Act of Aug. 4, 1955, ch. 561, § 2, 69 Stat. 497, 498)); it also excepted retired reserve officers and regular officers retired for disability incurred in the line of duty.

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[2] *See, Hostinsky v. United States*, 154 Ct. Cl. 443, 446, 292 F.2d 508, 510 (1961).

[3] Testimony of F.J. Scanlon, Nat. Secretary, Fleet Reserve Assoc., Hearing before the Comm. on Post Office and Civil Service, House of Reps., 88th Cong., 1st Sess. (Oct., 1963) on H.R. 7552 at 74.

[4] By the Act of May 31, 1924, Ch. 214, 43 Stat. 245, the 1894 Act was amended to exclude enlisted men and officers retired because of injuries or incapacity received in the line of duty, but this change did not affect those regular officers like plaintiffs who retired routinely at the completion of their active military careers.

Against this background, Congress passed the 1964 Act, part of which is now before us.[5] According to 5 U.S.C. § 5533, no one (with some exceptions) may receive the basic pay of more than one full-time civilian position in the federal government. The statute, however, liberalized the previous restrictions on retired regular officers (such as plaintiffs here). 5 U.S.C. § 5532(b), as we have noted, provides that retired regular officers can receive full pay for their civilian positions, subject to an annual reduction in retirement pay equal to the first $2,000 of that pay plus one-half of any remainder.[6] The Act continues the previous rule exempting retired reserve officers from dual compensation restrictions (5 U.S.C. § 5534).

Its legislative history teaches that the 1964 Act was designed to simplify and consolidate previous dual compensation laws (including the 1894 and 1932 Acts), regulations and administrative interpretations. Restrictions on retired regular officers were eased to give those officers a greater chance to fill civilian jobs, an opportunity Congress thought would benefit both the officers and the government.[7] Congress intended, by easing the then restrictions on retired regular officers, to give such persons civilian employment opportunities more in line with those available to retired reserve officers completely unaffected by dual compensation limitations. Congress did not, however,

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[5] The 1964 Act, PUB. L. No. 88-448, 78 Stat. 484, was incorporated into the codification of Title 5 of the U.S. Code, PUB. L. No. 89-554, Sept. 6, 1966, 80 Stat. 378, 482, and is now 5 U.S.C. §§ 3326, 3501-3502, 5531-5533, 6303.

[6] Section 5532(b) also states that "In the operation of the formula for the reduction of retired or retirement pay under this subsection, the amount of $2,000 shall be increased, from time to time, by appropriate percentage, in direct proportion to each increase in retired or retirement pay under section 1401a(b) of title 10 to reflect changes in the Consumer Price Index."

Subsection (c) excepts from coverage regular officers retired for line-of-duty disability or war wounds, as well as temporary or part-time civilian employees, and subsection (d) gives the Civil Service Commission and certain other officials power to grant other exceptions for special or emergency employment needs.

[7] The Act's legislative history states that "'* * * [T]he Government may be the loser because of these restrictions. Many skilled technicians, retired . . . from the Armed Forces, can be effectively utilized in civilian agencies. But because of the restrictions of present law, the Government cannot even offer these people employment even though many of them would prefer to remain in public service and are particularly suited to Federal employment. A major source of well-trained prospective employees is completely unavailable." S. REP. No. 935, 88th Cong., 2d Sess. 2 (1964) *reprinted in* [1964] U.S. CODE CONG. & AD. NEWS 2835.

entirely remove the restrictions on dual compensation for retired regular officers. It is this residue which is under attack in this suit.

B.

Plaintiffs' first, and less substantial, challenge is that 5 U.S.C. § 5532(b) constitutes a direct tax upon them, not in proportion to the census, and therefore in violation of article I, section 9, clause 4 of the Constitution.[8] This curious argument is rested on the purported purpose of the Economy Act of 1932, the true forerunner, plaintiffs insist, of the Dual Compensation Act of 1964. According to plaintiffs, the Economy Act was, in reality, a taxing statute designed to "increase" federal revenues during a time of great national financial distress. It is said that the 1932 limitations on dual compensation were a before-the-fact tax on certain officeholders and but for the goal of exacting this "tax" the compensation ceilings would have been lifted. The argument concludes that, since the 1964 dual compensation Act was a modernization and reenactment of the dual compensation provisions of the Economy Act of 1932, the later enactment is also unconstitutional on the same ground.

There are at least three conclusive answers to claimants' farfetched line of argument. First, the terms of the 1964 Act and its legislative history demonstrate that it was more than a mere replication of the Economy Act of 1932. As we have spelled out in Part A, *supra*, one of the basic goals of the later statute was to consolidate and simplify all prior dual compensation laws and regulations in one manageable law. Over 50 separate statutes and 200 Comptroller General (or predecessor) opinions were involved. *See* S. REP. No. 935, 88th Cong., 2d Sess. (1964), *reprinted in* [1964] U.S. CODE CONG. & AD. NEWS 2834. The history also shows that both the 1894 and 1932 Acts were being revised and, in

[8] This constitutional provision states:

No capitation, or other direct, tax shall be laid, unless in proportion to the census or enumeration herein before directed to be taken.

The clause was modified, of course, by the Sixteenth Amendment giving Congress power to tax income without regard to apportionment among the states or census count.

fact, the 1964 Act made more changes with an eye toward the 1894 statute than it did with respect to other prior pieces of legislation. We are convinced that it had a wider purpose and form than mere updating of the 1932 dual compensation legislation, and the sins, if any, of the latter should not be visited on the former.

But even if we were to agree with plaintiffs that the 1932 Economy Act was the direct forebear of and dominant influence upon the 1964 Act, we still could not agree that that statute was in any legal sense a tax measure. Of course, the Economy Act need not have been part of a "Tax Act of 1932" in order to impose, in reality, a direct tax. We assume that in applying article I, section 9, clause 4, the Supreme Court would look to substance rather than form. *Cf., e.g., American Oil Co. v. Neill,* 380 U.S. 451, 455 (1965); *Wisconsin v. J.C. Penney Co.,* 311 U.S. 435, 443 (1940); *Western Union Tel. Co. v. Kansas,* 216 U.S. 1, 30 (1910); *Galveston, Harrisburg Ry. v. Texas,* 210 U.S. 217, 227 (1908); *Henderson* v. *Mayor of New York,* 92 U.S. 259, 268 (1876). But here the substance was in direct historical descent from a long-standing policy limiting dual opportunities to receive pay from the federal government—a qualification upon federal employment and compensation, rather than a tax, direct or otherwise. Moreover, the debates prove that the 1932 Act (which not only contained a stringent ceiling on dual compensation but also provided for compulsory retirements, impoundment of appropriations, and reduced federal travel allowances) was enacted not as, but in lieu of, stringent tax measures. The objective was to restrict the overall expenditure of federal monies, thus alleviating to some extent the need to tax the general public in order to bring revenues back into the Treasury. One Congressman pointed out that the underlying intent was relief from taxation:

> I am opposed to adding greater burdens and additional taxation upon the already overtaxed people. [Rep. Sabath, 75 CONG. REC. 9076, April 27, 1932].

Another said:

> Rather than do this [increase taxes], let us cut the expenses of this Government $243,000,000 . . . [W]e must

> . . . tax . . . more or cut . . . expenses . . . . [75 CONG. REC. 8077–78, April 12, 1932].

Plaintiffs attempt to turn legislation designed to restrict federal expenditures into a tax measure by saying that the Act necessarily levied a tax accomplished through deprivation of putative increased benefits to retired officers like plaintiffs, and therefore became a revenue-producing device. This interpretation obviously strains the accepted legal definition of taxation to the bursting point, and would put in doubt any Congressional attempt to decrease or maintain through the appropriation mechanism statutorily-created benefits to recipients as a class. As many courts have said, a tax in legal contemplation is an exaction, taking money from the taxpayer for public purposes; it is an enforced proportional contribution of money or other property. The 1932 Act did not take from retired officers any money or property to which they were entitled.[9] It simply closed off to them, partially, another source of federal compensation (*i.e.* federal civilian pay) which Congress felt they should not also have.

Thirdly, even if we accepted plaintiffs' extraordinary notion that the 1932 Act imposed a direct tax upon retired officers, we would have to hold that the "tax", since it affected income received from the government, was an income tax within the Sixteenth Amendment. *See Simmons v. United States*, 308 F.2d 160, 167–68 (4th Cir. 1962).

C.

The claimants' major attack on the dual compensation law is that it treats retired regular officers differently from retired reserve officers with respect to holding federal civilian positions. The latter do not lose any retirement pay if they take a civilian post while regular officers have their retirement pay cut down. This is said to violate the equal

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[9] At least if retirement pay is not reduced in monetary terms from the level when the serviceman retired, even a retired officer has no vested or contractual right to any particular amount of retirement pay. *Andrews v. United States*, 175 Ct. Cl. 561, 562–63 (1966); *cf. United States v. Larionoff*, 431 U.S. 864, 879 (1977); *United States v. Teller*, 107 U.S. 64, 68 (1883).

protection component incorporated into the Fifth Amendment's Due Process clause.[10]

Under the Supreme Court's prevailing formulation the validity of the classification drawn by Congress in the dual compensation statute is to be examined under the "rational basis" standard—whether it is rationally related both to a legitimate governmental interest and to the objective of the particular legislation. *Ohio Bureau of Employment Services v. Hodory*, 431 U.S. 471 (1977); *Massachusetts Board of Retirement* v. *Murgia*, 427 U.S. 307, 312–14 (1976); *New Orleans v. Dukes*, 427 U.S. 297, 303 (1976); *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 813–14 (1976); *Johnson v. Robison*, 415 U.S. 361, 374–75 (1974); *Dandridge v. Williams*, 397 U.S. 471, 486–87 (1970). "Strict scrutiny" is not appropriate since the separate classification of retired regular officers is certainly not "drawn upon inherently suspect distinctions such as race, religion, or alienage" (*New Orleans v. Dukes, supra*, at 303; *see also Massachusetts Board of Retirement v. Murgia, supra*, at 313–14),[11] and the right to governmental employment is not *per se* "fundamental" in the constitutional sense. *See Massachusetts Board of Retirement v. Murgia, supra*, at 313; *Fredrick v. United States, supra*, 205 Ct. Cl. at 797, 507 F.2d at 1266.

One obvious purpose of the 1964 dual compensation law, as it was of the predecessor statutes, is in general to put a ceiling on the amount of compensation certain classes of individuals can receive from the federal government. This is, of course, a proper object of congressional concern. Setting the pay of federal officers and employees is, historically and constitutionally, within Congress's power. *Atkins v. United States*, 214 Ct. Cl. 186, 556 F.2d 1028 (1977). No one could gainsay Congress's authority to provide prospectively that all retired officers could hold a federal civilian position only at the cost of losing part or all

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[10] On this incorporation, *see, e.g., Bolling v. Sharpe*, 347 U.S. 497, 499 (1954); *Bruinooge v. United States*, 213 Ct. Cl. 26, 29, 550 F.2d 624, 626 (1977); *Fredrick v. United States*, 205 Ct. Cl. 791, 796 n.1, 507 F.2d 1264, 1266 n.1 (1974).

[11] In *Bruinooge v. United States, supra*, we applied the rational basis standard to a statute differentiating the whole class of military commissioned officers from that of non-officers.

of their retirement pay.[12] The only question is whether the statutory distinction challenged here—between retired regular and retired reserve officers—has rational support within an over-all project for limiting federal compensation and restricting dual office-holding.

While legislation over the years has made the conditions of service for regular and reserve officers more comparable,[13] important distinctions, relevant to dual compensation considerations, still exist. *See, e.g., Dandridge v. Williams, supra,* 397 U.S. at 485. The more lenient treatment of retired reserve officers for dual compensation purposes can be justified on two principal grounds. First, according to military regulations,[14] regular officers can normally serve longer and receive significantly higher retirement pay than reserve officers. As one Congressman noted for the record:

> They [retired regular officers] are a different group of people. The Regular officers do receive more advancement in their term of service and are allowed to go on for 30 years and receive 75 percent of their base pay when the vast majority of Reserve officers must retire at the end of 20 years and receive 50 percent of their base pay and do this at an earlier stage of life when they still have

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[12] Plaintiffs do not contest the right of Congress to reduce retirement pay for military personnel taking federal civilian jobs, if that is done non-discriminatorily. In view of the congressional right to limit total federal compensation, such across-the-board reduction would seem no more invalid than a flat prohibition on dual employment or a requirement that a new employee or officer divest himself of property which could cause a conflict-of-interest.

[13] Plaintiffs claim that by 1964 large numbers of reserve officers served full time in the military "under conditions identical in every respect to Regular officers." For example, they assert, reserve and regular officers receive the same kind of retirement privileges and benefits including the same identification cards, medical and commissary privileges, club memberships and airlift privileges. However, these similarities (and others of the same nature), to the extent they exist, do not make the two groups of officers virtually identical for all purposes. *See Taussig v. McNamara,* 219 F.Supp. 757, 761–62 (D.D.C. 1963), *affd generally,* D.C. Cir., *cert. denied,* 379 U.S. 834 (1964), upholding the validity of legislation (a) prohibiting a retired regular, but not a retired reserve, officer from participating in sales to the department in whose service he holds retired status, and (b) subjecting retired regular officers (but not retired reservists) to continuing court-martial jurisdiction.

Moreover, while it is true that there are many retired reservists who have served long periods on active duty, there are also many others who earned their retirement by part-time duty over a number of years, and never served for any extended time on full-time duty.

[14] *See, e.g.,* AR 635–100, § V (3–31), § III (4–20, 21, 25, 26).

children in school or college to educate. It is an entirely different situation. [Rep. Broyhill, 110 CONG. REC. 3018].

Congress, wanting to limit the total government compensation receivable by any one person, reduced the retirement pay of regular officers holding federal civilian jobs, with a view toward bringing their total compensation more in line with that of retired reserve officers in such civilian positions. This was neither wholly unreasonable nor invidious.

The second rational basis for the Act's differentiation between the classes of retired officers is premised on the difference between the military offices they hold. A regular officer who has retired remains a member of the regular armed services (*see, e.g.*, 10 U.S.C. §§ 3504(a), 8504(a)(1970)).[15] A retired reserve officer's status is different—he can be ordered to active duty only in time of war or national emergency after all active reservists have been called. 10 U.S.C. § 672(a)(1970). A retired regular officer, therefore, continues at all times to hold an office in the military—he is already a federal officeholder. That fact was one basis for the virtually complete prohibition of civilian officeholding by them in the past. The 1964 Dual Compensation Act can properly be viewed as some liberalization of the previously very stringent but lawful treatment of retired regular officers rather than as an attempt to continue an invalid discrimination against them. As in *Taussig v. McNamara, supra,* 219 F.Supp. at 761–62, the separation between regular and reserve retired officers is not arbitrary.

Minimizing these grounds for the legislative choice, plaintiffs lean heavily on efforts by the Executive Branch to have the differentiation removed as inequitable. The Cabinet Committee on Federal Staff Retirement System indicated in its 1966 report that the distinction in the dual compensation law between regular and reserve retired officers was contrary to consistency and equity (H. R. Doc. No. 402, 89th Cong., 2d Sess., March 7, 1966); the

[15] This court has held that a retired regular officer is validly subject to court-martial jurisdiction. *Hooper v. United States,* 164 Ct. Cl. 151, 326 F.2d 982, *cert. denied,* 377 U.S. 977 (1964).

Committee's staff went a bit further and referred to the "discriminatory treatment of the retired Regular officer vis-a-vis the retired Reserve officer or enlisted member," and could not see "any logical reason" for the "penalty" on the regular officer (SEN. DOC. No. 14, 90th Cong., 1st Sess., Apr. 6, 1967). In 1970 the Department of Defense, asking Congress to eliminate the difference, said that "logic and equity" dictated similar treatment and pointed to the "inconsistency and inequity" of the existing restriction. The Civil Service Commission, labeling the distinction as "discriminatory," wrote to Congress that it would not object to the enactment of legislation removing "this inequity to retired regular officers."[16]

Like many terms used in the law, the words "discriminatory," "illogical," "unfair" and "inequitable" have different values in different contexts. They are fitting for an agency to use in trying to persuade Congress to change a rule which the agency deems unjust as a matter of good employment policy. But a court's task in evaluating (where the test is the rational basis standard) the constitutional validity of that same rule is quite another function. The court cannot strike down the Congressional choice because it believes Congress erred or made a wrong policy decision or even because the result seems "unfair" in some general sense. If the distinction embodied in the law is reasonably related to a legitimate governmental interest which Congress seeks to advance, the court must uphold the rule even though it may seem unwise or that a more just system could clearly be devised. *See Ohio Bureau of Employment Services v. Hodory, supra; Massachusetts Board of Retirement v. Murgia, supra; Dandridge v. Williams, supra.* The "opposed views of public policy are considerations for the legislative choice." *North Dakota State Board of Pharmacy v. Snyder's Drug Stores, Inc.*, 414 U.S. 156, 167 (1973). Congress has the authority to choose, and we cannot impose our own judgment, or that of others within the government, if there is any reasonable basis for what Congress has done. *See Lehnhausen v. Lake Shore Auto*

[16] Congress did not accede to these requests to change the dual compensation statute.

Parts Co., 410 U.S. 356, 359–60, 365 (1973). If the legislature may properly think that an evil is specially acute for one group (such as retired regular officers as a class), it may select that aspect "and apply a remedy there, neglecting the others." *See Williamson v. Lee Optical Co.*, 348 U.S. 483, 489 (1955).[17] Similarly, a classification with a rational basis will not be set aside because it is "imperfect" or lacking "mathematical nicety," or because "in practice it results in some inequality." *Dandridge v. Williams, supra*, 397 U.S. at 485; *McGowan v. Maryland*, 366 U.S. 420, 425–26 (1961); *Lindsley v. National Carbonic Gas Co.*, 220 U.S. 61, 78 (1911); *Bruinooge v. United States, supra*, 213 Ct. Cl. at 32, 550 F.2d at 628.

Finding as we have that there is a rational basis for singling out retired regular officers with respect to dual compensation, we cannot deny to Congress, the legislative branch of the federal government, the right in its own judgment to make that distinction. *See Alexander v. Fioto*, 430 U.S. 634 (1977). There is no "invidious discrimination" vulnerable to the Fifth Amendment, though the law's impact may seem to us or to others to have elements of unfairness. To remove those possible inequities, plaintiffs and their class must resort to Congress, not to the courts.

Aside from the exemption of retired reserve officers, claimants take a glancing blow at the provision of the dual compensation law (5 U.S.C. § 5532(d)) for exceptions for "special or emergency employment needs which otherwise cannot be readily met."[18] This standard for exceptions

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[17] Dual compensation is a subject to which Congress returns from time to time, and at any moment it "may take one step at a time" and "may select one phase of one field," as it sees the need. *Williamson v. Lee Optical Co., supra; Jefferson v. Hackney*, 406 U.S. 535, 546 (1972); *Geduldig v. Aiello*, 417 U.S. 484, 495 (1974). There are indications that, at the present time, there may be some Congressional interest in applying some type of dual compensation limitation to certain retired reserve officers as well as to retired regulars.

[18] The Civil Service Commission, subject to the President's supervision and control, prescribes regulations under which such exceptions can be made within the Executive Branch. The President of the Senate, the Speaker of the House, and the Architect of the Capitol have the same authority for their legislative components. The Administrator of the National Aeronautics and Space Administration also has similar specific authority for not more than 30 exceptions.

plainly has rationality and Congress cannot be faulted for permitting leeway in the face of such necessity.[19]

It is urged, finally, that even if the statute would otherwise be valid it should be read to provide merely for temporary deferment of the withheld portion of the regular's retired pay, rather than for complete elimination of that part. As with the comparable statutory argument in *Alexander v. Fioto, supra,* the text and purpose of this enactment refute the suggested reading. The law provides that, during the period the retired regular officer holds a civilian position, "his retired or retirement pay shall be *reduced*" (emphasis added), not deferred; and reduction is necessary to meet the declared objective of the statute to limit the over-all compensation paid to such officers by the United States. That has been the consistent interpretation since 1964.

For these reasons, we grant defendant's motion to dismiss the petitions and deny plaintiffs' cross-motion for summary judgment. The petitions are dismissed.

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564 F.2d 53

WESTERN ELECTRIC COMPANY, INC. v. THE UNITED STATES

[No. 23–75. Decided October 19, 1977. Defendant's motion for rehearing denied November 25, 1977.]

OPINION

Taxes; excise tax; communication facilities and services; Centrex associated services; "separate charge"; "necessary and unique".— Plaintiff, a subscriber to telephone communications services and subject to the same telephone service rates as ordinary subscribers, seeks to

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[19] Plaintiffs also make a convoluted argument that 5 U.S.C. § 5532 violates the Fourteenth Amendment via the Ninth and Tenth Amendments. This seems to say no more than that, since the distinction between retired regulars and retired reserves is invidiously discriminatory, it could not be made by the states under the Fourteenth Amendment and therefore could not be delegated to the Federal Government under the Ninth and Tenth Amendments. Because we have held, contrary to plaintiffs' contention, that the distinction, as made in this statute, is not invidiously discriminatory, we need not stop to discuss whether the Fourteenth Amendment can ever be invoked against a federal statute.

Syllabus

recover assessed Federal excise taxes and interest, plus statutory interest, for the period from April 1, 1971 through October 31, 1971. During that period plaintiff subscribed to Centrex telephone service, which included local exchange service, and a private communication service entitling plaintiff to the use of intercommunications system for its own telephones; both services were furnished by Illinois Bell Telephone Co. The basic intercommunications system and the local exchange service were billed together; there is no dispute as to the excise tax status of such services. Plaintiff also subscribed to certain Centrex associated services, including switchboards, extension telephones, multi-button telephones, etc. which were useful to its private intercommunication service. Plaintiff was billed separately for these associated services and paid the charges under applicable tariffs filed with the Illinois Commerce Commission. The dispute for resolution in this action is the taxability of the associated services. Plaintiff contends that such services are not subject to the excise tax imposed by Sec. 4251 of the Internal Revenue Code of 1954, because its services are "private communication services" within the exemption of Sec. 4252(d)(2) and that it meets the requirement thereof. Since defendant's position on the question of whether plaintiff paid "a separate charge" for the associated services is unclear, the court *holds* that there was a separate charge within the meaning of Sec. 4252(d) in view of the Act's legislative history, certain negotiations preceding passage of the Act, and the statute's language. The court also *holds* that Rev. Rul. 73–270 misconstrues the exemption of Sec. 4252(d); it was not the intent of Congress that until separate charges are made for the local exchange service and for the basic intercommunication service, no Centrex service "of any kind" is exempt. The court also *holds* that Rev. Rul. 74–590 and 77–189 constitute unreasonable and erroneous interpretations of the law; that the associated services meet the requirement of a "private communication system" as defined in Sec. 4252(d) in that these services are both "separately charged" and "necessary * * * to the use" of a private communication system; that the term "necessary" as used in said section means "appropriate and useful", and that the charges collected for the associated services are therefore exempt from the excise tax imposed by Sec. 4251. Judgment is entered in favor of plaintiff in the sum of $28,069.31, plus statutory interest.

Taxes; excise tax; communications facilities and services; private communication service; legislative history.

[1] As revealed by its legislative history, the principal objective of The Excise Tax Reduction Act of 1965, as codified at 26 U.S.C. §§ 4251, et seq., was to eliminate the competitive handicap which had been generated, because private communication services furnished by the telephone companies under the Centrex system were taxable while functionally equivalent services provided by subscriber-owned equipment were not taxable.

Internal Revenue ⇨1163

Syllabus

Taxes; excise tax; communications facilities and services; private communication service; legislative intent; separate charges.

[2] Revenue Rul. 73–270 is unduly restrictive, misconstrues the legislative history of 26 U.S.C. § 4252, and reaches an erroneous result. Congress did not intend that until separate charges are made for local exchange services and for the basic intercommunication service, no Centrex service *of any kind* may be exempt. On the basis of the legislative history, it may be inferred that Congress understood that the associated services provided by telephone companies under the Centrex system would be exempt from tax under The Excise Tax Reduction Act of 1965, so long as a separate charge was paid for such services.

Internal Revenue ⚖1163, 1202

Taxes; excise tax; communications facilities and services; private communication service; statutory language; separate charges.

[3] The language of 26 U.S.C. § 4252(d) that "a private communication service does not include any communication service unless a separate charge is made for such service," means that if a separate charge is made for "any" of the three categories of private communication services, the separate charge requirement is met.

Internal Revenue ⚖1163

Taxes; revenue rulings; binding effect of.

[4] While revenue rulings may be helpful in interpreting a statute in some cases, they are not binding either on the courts or the Secretary of the Treasury.

Internal Revenue ⚖1202

Taxes; revenue laws; construction and operation; ordinary meaning of terms.

[5] In determining whether the associated services in issue are "necessary or unique" within the meaning of Sec. 4252(d)(1), there is virtually no legislative history explaining the meaning and application of the phrase. Therefore, "necessary" must be interpreted in its particular context; it must be read in connection with the other provisions of Sec. 4252, and it must be construed in accordance with results which Congress sought to achieve in passing The Excise Tax Reduction Act of 1965. "Necessary" means "appropriate and helpful" within the intent of Sec. 4252(d), and as such, taxpayer's associated services qualify for the tax exemption.

Internal Revenue ⚖1163

Taxes; revenue rulings; excise tax; communications facilities and services; private communication service.

[6] Revenue Rul. 74–590 is inconsistent with the plain language of Sec. 4252(d)(1), which provides that the private communication service shall be exempt from tax "regardless of whether such * * * intercommunication system may be connected through switching" to local telephone service.

Internal Revenue ⚖1163, 1202

Opinion of the Court

Taxes; revenue laws; construction and operation; generally.

[7] If there is a serious doubt as to taxability, the doubt should be resolved in favor of the taxpayer. Here there is such doubt. The Excise Tax Reduction Act of 1965 contains no definition of the phrase "necessary or unique" as used in Sec. 4252(d). Moreover, there is virtually no legislative history explaining what Congress intended by it, and the pertinent revenue rulings are conflicting and provide strong evidence of doubt and confusion by the Internal Revenue Service as to the correct interpretation of the phrase.

Internal Revenue ⚖1163

Taxes; revenue laws; construction and operation; equitable construction.

[8] Where a particular construction of a statute will produce inequity and injustice, such a construction is to be avoided if another and more reasonable interpretation is perceived.

Statutes ⚖182

Ralph A. Muoio, attorney of record for plaintiff. *Mortimer M. Caplin, Ronald B. Lewis, Caplin and Drysdale,* and *E. R. Charvat,* of counsel.

Donald H. Olson, with whom was *Acting Assistant Attorney General James D. O'Brien,* for defendant. *James L. Malone, III,* of counsel.

Before COWEN, *Senior Judge,* DURFEE, *Senior Judge,* DAVIS, NICHOLS, KASHIWA, KUNZIG and BENNETT, *Judges, en banc.*

COWEN, *Senior Judge,* delivered the opinion of the court:

Plaintiff brought this action to recover the sum of $28,069.31, plus statutory interest, for Federal excise taxes assessed against and paid by it for the period from April 1, 1971 through October 31, 1971.

During the taxable period, plaintiff subscribed to Centrex telephone service furnished by the Illinois Bell Telephone Company. The basic Centrex service to which taxpayer subscribed included local service (referred to herein as local exchange service) over the lines of the Illinois Bell Telephone Company, and a private communications service which entitled the taxpayer to the use of the intercommunications system for its own telephones. There is no dispute on the excise tax status of such service during the period in issue, during which time the charge for the

basic intercommunications system was not billed separately from that provided for the local exchange service. In addition and in connection with its Centrex service, plaintiff subscribed to certain associated services, including switchboards, extension telephones, multi-button telephones, and others, which were appropriate and useful to the private intercommunication service. Plaintiff paid separate charges under the applicable tariffs for each of these associated services. The question for decision is whether the amounts paid for the associated services are subject to the Federal communications excise tax imposed by the Excise Tax Reduction Act of 1965, Pub. L. 89–44, 79 Stat. 136.

This case comes before the court on a stipulation filed by the parties. For the reasons set forth below, we find that plaintiff is entitled to recover, and we enter judgment in its favor for the amount claimed.

Plaintiff is a New York corporation engaged in the manufacture and sale of communication equipment to the Bell System companies. Although it has manufacturing, service, office and warehouse locations throughout the country, the operation involved in this suit is the Hawthorne Works, plaintiff's oldest and largest manufacturing plant, located in Chicago, Illinois. Plaintiff brings this action not as a producer but as a consumer (subscriber) of telephone communications services at the Hawthorne plant. Even though it is a subsidiary of the American Telephone and Telegraph Company (AT&T) and a part of the Bell System, it must pay the same rates for telephone service as do all other subscribers. It is charged according to "tariffs" filed with and approved by the Illinois Commerce Commission, and imposed by the Illinois Bell Telephone Company (Illinois Bell).

As a subscriber of telephone services, Western Electric must pay a Federal excise tax upon certain of the communications services it uses. This tax, first enacted in 1941 as a wartime revenue measure[1], was amended by the Excise Tax Reduction Act of 1965,[2] and is now codified as

[1] Revenue Act of 1941, Pub. L. 77–250, 55 Stat. 687.
[2] Pub. L. 89–44, 79 Stat. 136.

26 U.S.C. §§ 4251, et seq. The tax is imposed upon "local telephone" and other services.[3] However, the tax is specifically not applicable to "private communications services," (commonly known as "intercoms"), as defined in the Code, when those services are furnished either by telephone companies as part of their regular services, or are sold outright to consumers by communications companies. Hereafter, the latter will be referred to as "subscriber-owned."

The equipment which is commonly available in connection with an intercom is not limited to the basic communication service, but includes a number of "associated services" which make the operation of the intercom more flexible and convenient. Plaintiff, which had over 4,000 telephones in its Hawthorne plant, utilized a wide variety of these associated services in its operations. The associated services may be grouped into four general categories:

1. *Consoles.* These are desktop switchboards through which an attendant may answer calls to the subscriber's main number, transfer incoming calls from one station to another, and control internal calls from one telephone to another. These consoles are also referred to as "attendant positions."

2. *Key Set Telephones.* These permit communication over more than one line; they contain a "key set" consisting of five station buttons and one hold button which light up or blink when in use.

3. *Call Director Sets.* Essentially expanded versions of key sets, these instruments are normally used by secretaries or other personnel who need more than six lines.

4. *Other.* This catch-all category includes a number of different items such as extension telephones, speakerphones (which permit "hands-free" operation), special "hold" capabilities and, for some areas of plaintiff's plant, telephones especially constructed for use around explosives.

Plaintiff obtained the use of this equipment not through outright purchase, but upon subscription to what is known

[3] Other services include "toll telephone services" and "teletypewriter exchange service." Any service which does not fall within one of these three categories is not taxed. *See* the full text of the statute, reproduced *infra*.

as the Centrex system of business telephones. Centrex is a system which permits both local exchange access and intercom services over the same line. The subscriber may place and receive outside calls directly, without resort to an on-the-premises attendant operator, or he may use the operator where necessary. If he desires to make an intercom call, he dials a four-digit number which connects him directly to the other intercom station, obviating reliance upon a switchboard or upon the local exchange network. The attendant position may also be used, however, in circumstances where an outside caller wishes to contact the business generally or does not know the particular office number desired.

Under the Centrex system the subscriber was, at the time period now in suit, charged with a single basic service charge for both local exchange and basic intercom services.[4] This was necessary because the Illinois Bell Telephone Company could not separate its Centrex line tariff into a charge for exchange access and another for basic intercommuncation service except upon application to and approval by the Illinois Commerce Commission. This unified or "bundled" charge did not include a charge for the "associated services," however. Plaintiff and other subscribers were billed separately for each associated service according to the extent of each service's use. For plaintiff's Hawthorne plant during the period in dispute, plaintiff was billed $175 per month for each of three consoles it used, $12 each for monthly use of between nine and 29 call director sets, and $1,377.50 for use of 551 key sets.

Centrex was not the only system provided by telephone companies for simultaneous intercom-local exchange service. Illinois Bell had other Private Branch Exchange Systems (PBX) which provided slightly different service. In these other PBX systems there are a number of "trunk" lines which connect the local exchange to switching equipment on the premises. During the taxable period, a subscriber to PBX from Illinois Bell would be billed on the

[4] Tariffs were modified by the Illinois Commerce Commission in 1971 (a few months after the period in dispute) to permit "unbundling" or separation of intercom and local exchange service within the basic Centrex service charge.

basis of three separate tariffs on file with the Illinois Commerce Commission. First, there was a tariff charge provided by each of the trunk lines that gave access to the subscriber's telephone system with a PBX service; secondly, there was a tariff charge for each of the services provided by PBX switching equipment, station line connections and stations (which provide PBX private communication service over lines referred to hereinafter as "PBX station lines") and thirdly, there was a separate tariff charge for each of the associated services previously described.

Throughout the taxable year involved here, PBX stations were not allowed to receive or place calls directly to outside lines, but had to route calls (both incoming and outgoing) through a central operator on the premises. This has since been modified, so that PBX is now functioning essentially the same as Centrex in its method of placing calls. The only significant difference between Centrex and PBX for purposes of this controversy is that under the PBX system, separate charges are made for intercom, local exchange, and associated services, while the Centrex system has separate charges only for the associated services and the unified local exchange and intercom service.

During the period pertinent to this suit, a business which desired an intercom service was not limited to a choice between Centrex and PBX systems provided by a telephone company. The subscriber could also purchase intercom equipment outright from a communications equipment manufacturer, and the equipment was functionally equivalent to that offered by telephone companies. Prior to January 1, 1969, only railroads, electric power companies, and pipeline companies were permitted to interconnect the subscriber-owner equipment, to the local exchange service. Thereafter, the telephone company tariffs permitted all subscribers to interconnect certain subscriber-owned equipment, so that all subscribers had access to the same service as those having PBX and Centrex systems. The equipment which was available for purchase was every bit as sophisticated and varied as that available upon subscription to a telephone company. Subscriber-owned equipment may have appeared less inviting than Centrex or PBX

service in that it had to be purchased, rather than rented for a monthly phone bill. But the purchaser of the equipment enjoyed a distinct and important advantage over the Centrex or PBX subscriber - his equipment was free of the Federal excise tax.

It was in order to correct the competitive imbalance existing between telephone company-furnished services and subscriber-owned equipment that Congress passed section 4252 of the Internal Revenue Code of 1954, as amended. That much, at least, is clear from a reading of the House and Senate Committee reports accompanying the passage of the Act:

> * * * The telephone companies presently are losing intrapremise business (and interpremise business within local areas) to those providing telephone and microwave equipment which can be purchased and operated by the users themselves. Installation of equipment in this manner is accompanied by a reduction in the service from the local telephone company. Businesses installing their own internal communications system in this manner avoid the tax on the telephone company's charge for both equipment and services. With the ever-increasing number of varied services which modern science makes it possible for telephone companies to provide, the tax on private communication systems represents a severe competitive handicap to the expanded use of these new and varied services. [H.R. Rep. No. 433, 89th Cong., 1st Sess., *reprinted in* 1965 *U.S. Code Cong. & Admin. News* 1677.]

The immediate effect of the 1965 Excise Tax Reduction Act was to eliminate the tax upon "private communication service" as defined in the Act, when the service is provided by telephone companies in connection with their regular service. However, the precise extent of the tax exemption has not been clarified. In the belief that the associated services had been exempted from tax, Illinois Bell did not bill or collect from plaintiff any excise tax upon the "associated services" used in connection with either Centrex or PBX services. Similarly, the telephone company did not collect any tax upon that part of PBX systems which was separately billed for service provided by the "PBX station lines." However, it did collect from plaintiff

an excise tax on the amount billed for the unified exchange and basic intercom Centrex service.

Plaintiff has never contested the tax collected by Illinois Bell upon the unified, unbundled charges. The Government, for its part, has not contested the tax exemption allowed for "PBX station lines" service provided by the PBX switching equipment station line connections and stations, nor has it sought to tax PBX associated services until quite recently.[5] As previously indicated, the dispute to be resolved in this action is the taxability of the associated services used in connection with Centrex systems. On June 1, 1974, the Internal Revenue Service (I.R.S. or Service) notified plaintiff that the Government would assess and collect an excise tax upon the Centrex associated services used by plaintiff for the taxable period April 1, 1971 through October 31, 1971. Plaintiff filed a timely claim for refund of the tax, but the I.R.S. denied the claim on December 20, 1974. Thereafter, plaintiff paid the tax and filed this suit for a refund.

Although plaintiff brings this suit only on its own behalf and for a relatively small sum, we recognize that a final decision on the issues presented here may have a far broader impact than the taxability of the associated services used in plaintiff's Hawthorne plant. During the period from 1965 to 1973, there were as many as 2,500 subscribers to Centrex service in the United States. There are currently in audit or otherwise pending before the I.R.S., numerous cases involving the excise tax assessed against these subscribers for the use of their Centrex associated services. As of the date this suit was filed, those related cases were being held in suspense.

I.

The system of taxation of telecommunication services established by 26 U.S.C. §§ 4251 *et seq.* is relatively

[5] As late as the filing of the stipulation of facts before the court, the I.R.S. field offices had "not been instructed to assert and [had] not asserted that the associated services provided in connection with PBX service * * * are subject to * * * tax." [Stip. No. 49.] This situation has changed with the publication of Rev. Rul. 77-189, discussed *infra*.

straightforward. To be taxable, a service must be "local telephone service," "toll telephone service," or "teletypewriter exchange service." 26 U.S.C. § 4251(a). As far as plaintiff is concerned, its "associated services" must fall within the definition of "local telephone service" to be taxable. Plainly, its associated services are not covered by either of the remaining two categories.

"Local telephone service" is defined by 26 U.S.C. § 4252(a) as follows:

> (1) the access to a local telephone system, and the privilege of telephonic quality communication with substantially all persons having telephone or radio telephone stations constituting a part of such local telephone system, and
> (2) any facility or service provided in connection with a service described in paragraph (1).
>
> The term "local telephone service" *does not include* any service which is a "toll telephone service" or a *"private communication service"* as defined in subsections (b) and (d). [Emphasis added.]

It is plaintiff's contention that the services upon which it has been taxed are "private communication services" and are therefore not subject to the excise tax imposed by section 4251. Section 4252(d) defines "private communication service" as:

> (1) the communication service furnished to a subscriber which entitles the subscriber—
>
> (A) to exclusive or priority use of any communication channel or groups of channels, or
> (B) to the use of an intercommunication system for the subscriber's stations,
>
> regardless of whether such channel, groups of channels, or intercommunication system may be connected through switching with a service described in subsection (a), (b), or (c),
>
> (2) switching capacity, extension lines and stations, or other associated services which are provided in connection with, and are necessary or unique to the use of, channels or systems described in paragraph (1), and
> (3) the channel mileage which connects a telephone station located outside a local telephone system area with a central office in such local telephone system,

except that such term does not include any communication service unless a separate charge is made for such service.

It is conceded that the associated services subscribed and paid for by plaintiff are "private communication" services referred to in section 4252(a). However, in order to prevail here, plaintiff must meet two requirements of section 4252(d). First, plaintiff must show that it paid "a separate charge" for such associated services, and second, plaintiff must establish that the associated services are "necessary or unique to the use" of the private communication service. Each of these requirements will be separately discussed.

The "separate charge" issue has provided some confusion because of the shifting and contradictory positions defendant has assumed in the presentation of its case. The audit and assessment of the disputed taxes were based on the Government's contention that the "separate charge" requirement was not met, and much of plaintiff's moving brief was addressed to that question. However, it is undisputed that the plaintiff did in fact pay a separate charge for the associated services and in its brief, defendant conceded that plaintiff had, to that extent, qualified for the tax exemption authorized by section 4252(d). Defendant's brief stated:

> The associated services in issue were provided in connection with both "local telephone service" described in Section 4252(a)(1) and an internal "intercommunication system" described in Section 4252(d)(1). Those associated services thus meet the threshold definitional requirements of both Section 4252(a)(2) (taxable "local telephone service") and Section 4252(d)(2) (nontaxable "private communication service"). Moreover, *we agree with taxpayer that a separate charge was made for each of the associated services in issue as required by Section 4252(d).* * * * [Defendant's Brief, at p. 14, emphasis added.]

Relying on the quoted language, plaintiff in its reply brief naturally assumed that the separate charge issue had been removed from this case, but in oral argument, defendant apparently withdrew its concession and reasserted its reliance on revised Rev. Rul. 73–270, 1973–1, C.B.

444, which declared that the separate charge requirement was not met.[6] Since defendant's position on this question is unclear, we resolve the doubt by holding that there was a separate charge for the associated services within the meaning of section 4252(d).

Our conclusion is based on three factors: (1) the legislative history as embodied in the reports of the House and Senate Committees on the Excise Tax Reduction Act of 1965; (2) negotiations between representatives of the American Telephone and Telegraph Company and the staff of the Joint Committee on the Internal Revenue Taxation preceding the passage of the Act; and (3) the language of the statute itself.

Since both parties claim support from the legislative history we consider it first. The first portion of the Committee Reports describe the "severe competitive handicap" that the telephone companies were subjected to under existing law, because private communication services furnished by them were taxable, whereas functionally equivalent services provided by subscriber-owned equipment were not taxable. As previously stated herein, the principal objective of the 1965 Act was to eliminate this competitive disadvantage. With respect to the separate charge question, the Committee Reports read as follows:

> For the reasons indicated above, your committee's bill provides an exemption from the tax on local telephone service for private communications service if a separate charge is made for this service. It is understood that private lines and PBX systems generally will immediately qualify for this exemption. However, it is understood that Centrex systems—where the switching equipment is generally on the premises of the local exchange rather than on that of the subscriber—generally do not, as yet, provide for a charge which is separate and distinct from that for local telephone service. *Until such a separation is made, this exemption, therefore, will not apply in the case of Centrex service.* [H. R. Rep. No. 433, 89th Cong.,

[6] The defendant's position denying the exemption for failure to meet the "separate charge" requirement was originally set forth in Rev. Rul. 73-270, *infra*. In oral argument, defendant declared: "The taxpayer insists all through its brief that we have conceded or abandoned the 1973 ruling. We have not conceded or abandoned the ruling; the ruling speaks for itself."

1st Sess., *reprinted in* 1965 *U.S. Code Cong. & Admin. News* 1677; emphasis added.]

Relying solely on the quoted language, the Government issued its Rev. Rul. 73–270 which held that the associated services were not exempt from tax even though they were charged separately, unless and until the basic Centrex service charge was broken down with separate billings for local exchange service and for the basic intercommunication system. The revenue ruling declared:

> * * * it is the intention of Congress that, when Centrex service with unrestricted stations is furnished to a subscriber, the charge for the entire service package is subject to the tax imposed on local telephone service by section 4251(a)(1) of the Code if there is not a separate charge for that part of the service furnished that represents private communication service.
>
> In the instant case the charge for the Centrex service furnished is not broken down between local telephone service and private communications service. Thus, amounts paid for the Centrex service furnished must be considered as amounts paid for local telephone service, and all facilities and services furnished therewith must be considered as being provided in connection with local telephone service * * *. [Rev. Rul. 73–270, 1973–1, C.B. 444, 445.]

In our opinion, the ruling is unduly restrictive, misconstrues the legislative history, and reaches an erroneous result. We do not believe that it was intended by Congress that until separate charges are made for the local exchange service and for the basic intercommunication service, no Centrex service *"of any kind"* may be exempt. The reports state that "Centrex systems * * * *generally* do not, as yet provide for a charge which is separate and distinct from that for local telephone service," and that "*until such a separation is made,* this exemption, therefore, will not apply in the case of *Centrex service.*" [H.R. Rep. No. 433, *supra,* emphasis added.]

We think that this portion of the report refers only to the unified, bundled Centrex service charge and indicates that no part of this charge would be exempt from tax until the charge for the local exchange service was separated from the charge for the basic intercom service. No reference was

made to the associated services provided by the telephone companies under the Centrex system, and since it was known that those charges had been separately billed, we think it follows logically that there was no Congressional intent to tax the separately billed associated services.

That this was the meaning of the statement contained in the Committee Reports becomes fairly clear upon examination of the background of section 4252. The background strongly indicates that the Congressional Committees understood that the associated services separately charged under the Centrex system would be tax exempt upon the passage of section 4252(d). Section 4252 resulted partly from a bill drafted by the American Telephone and Telegraph Company, known as "Draft A," and an Administration proposal. Draft A purported to establish the same nontaxable status for telephone-company furnished intercom service as had previously applied to subscriber-owned intercom equipment. Although Draft A provided that no tax would be imposed on any amount paid for private communication service if the service was used in the conduct of a trade or business, the significance of Draft A for our purposes is that it provided that the charge for the basic private communication service served by a local telephone system and connected with such local exchange service, would not be tax exempt unless a separate charge was paid for the intercom system, whereas no such requirement was contained in Draft A for the associated services used in connection with the basic intercom system. In this connection, it is to be remembered that at the time Draft A was submitted to the Joint Committee, the Centrex system to which plaintiff subscribed did not provide a charge for the local exchange service separate from that for the basic intercom system. However, there was a separate charge for the Centrex associated services. In the Fall of 1964 and prior to the passage of the 1965 Act, there was a meeting at which the staff of the Joint Committee requested the AT&T representatives to supply information as to the revenue loss that would be involved if the charges for Centrex service were separated into those for local telephone service and for private communication service, which would be exempt under the business use exemption

proposed in Draft A. The general tax attorney for AT&T responded to that request by letter of December 17, 1964, addressed to the Chief of the Staff of the Joint Committee and reading as follows:

> The following are answers to the three questions with regard to Centrex service that you gave to Mr. R. J. Foulis, and which, for the purpose of clarifying our understanding of the questions, I discussed with you by telephone on December 8.
>
> 1.
>
> In the first question you ask how much revenue loss we believe would be involved if the charges for Centrex service, as provided in current tariffs, could be separated so as to identify the part for local telephone service and the part for private communication service (which latter part would be exempt from tax under the business use exemption in Draft A).
>
> The monthly charge for Centrex service is the total of separate charges for each attendant position, each unrestricted telephone station, and each restricted telephone station for which a customer subscribes. An attendant position is a switching arrangement, at which an attendant may redirect incoming calls to the unrestricted telephone stations and assist in the placing of toll calls. An unrestricted telephone station has access to the local telephone system and is entitled to local exchange service, as well as to intercommunication service with all other stations in the Centrex service. A restricted station provides only intercommunication service with the other Centrex stations. The charge per restricted station is less than the charge per unrestricted station, since the latter reflects the additional value of local exchange service.
>
> Each of these charges varies in amount among the several telephone companies. Also, within each company the charge per unrestricted station varies in accordance with the total number of stations to which the Centrex customer subscribes (being somewhat lower for the larger systems than for the smaller). We think, however, that a reasonably accurate estimate of current *average monthly* charges is: $125 per attendant position, $7.50 per unrestricted station and $3.50 per restricted station. (These average monthly charges are used in all discussion and tax estimates that follow.)

An estimate of the tax revenue that would be lost if Draft A were to be applied to Centrex requires analysis of each of these three charges separately, as follows:

The charge for an attendant position would be a charge for private communication service within the definitions of Draft A, and would be entitled to the business use exemption. Application of Draft A would exempt this charge *without change* in the Centrex tariffs currently in effect. * * *

The charge for a restricted telephone station would also constitute a charge for private communication service *without change* of current tariffs. * * *

Substantial tax revenue loss (in addition to the $123 million) would result only if the charge for an unrestricted station under tariffs currently in effect were to be separated into two charges, one specifically identifiable as the charge for the local exchange service privilege (taxable under Draft A), and the other for intercommunication service (subject to the business use exemption). * * *

* * * * * *

[Plaintiff's Exhibit 17, pp. 1–4; emphasis in original.]

The understanding regarding the proposed taxability of Centrex service as reflected in this letter is threefold: First, where the service is devoted exclusively to intercommunication (*i.e.*, a restricted station), it would be tax exempt without any change in the existing tariffs. Second, where the telephone company provided unrestricted Centrex service (both intercom and local exchange service) the service would be subject to the excise tax until the telephone company separated its tariff into one charge for the local exchange service and another for the basic private intercommunication service. Third, and to the point on the question before us, the associated services provided by the Centrex system for which subscribers were already being charged separate rates, such as an "attendant position" (console switchboard), would be exempt from the tax without any change in the Centrex tariffs then in effect.

On the basis of this background information, we think it may reasonably be inferred that the Congressional Committees understood that the associated services provided under the Centrex system would be exempt from tax under

the new law to be enacted, so long as a separate charge was paid for such service.

Our view of the intent of section 4252(d) is, we think, also clearly supported by the statutory language itself. It will be observed that section 4252(d) defines three types or categories of "private communication service." The first type is described in subsection (d)(1)(B) as the use of an intercommunication system for the subscriber's stations, regardless of whether the system may be connected through switching to "local telephone service." A second type of "private communication service" is separately defined in subsection (d)(2) as the several kinds of associated services which are in issue here. The third category is "channel mileage" covered by subsection (d)(3). The concluding clause in subsection (d) states that a "private communication service does not include *any communication* service unless a separate charge is made" therefor. To us this language, particularly the use of the word "any," means that if a separate charge is made for "any" of the three categories, the separate charge requirement is met.

II.

The principal issue in this case is raised by the Government's defense that the associated services to which plaintiff subscribed do not qualify for the tax exemption, because they are not "necessary or unique" to the "private communication service" defined in section 4252(d)(1). This is the only argument asserted by the defendant in its brief to the court. Defendant has stipulated that the associated services are appropriate and helpful in connection with the use of plaintiff's intercom system, and in its brief to us, defendant does not contend that an associated service must be used exclusively in connection with the intercommunication system to meet the "necessary or unique" requirement. Rather, it is defendant's position that to qualify for the exemption, the associated service must be *technologically* essential to the use of the intercommunication system referred to in section 4252(d)(1)(B).

Plaintiff concedes that the associated services are not "unique," but argues that they are "necessary" in that they are "appropriate and helpful" to the use of the intercommunication system.

Defendant's primary position in this litigation parallels that which is set forth in two revenue rulings, Rev. Rul. 74–590, 1974–2 C.B. 364 and Rev. Rul. 77–189, 1977–1 C.B. 342, (May 31, 1977). In view of these rulings, we think it will be helpful to summarize the various positions taken by the Internal Revenue Service in revenue rulings on the taxability of the associated services. As previously stated, the I.R.S. had in 1973 in Rev. Rul 73–270, held that associated services used in connection with a basic Centrex intercom system were taxable, because the unified charge for the Centrex service was not divided into separate charges for the intercom system and local exchange services. After the telephone companies responded to this holding by unbundling the charge for the Centrex service by breaking down the charges between local service and private communication service, another request was made for a ruling granting the tax exemption for the associated services. In Rev. Rul. 74–590, the taxpayers were again turned down, this time on the ground that the equipment was not "necessary or unique" to the use of the private communication system. This ruling contains no rationale which supports the conclusion stated.

The promulgation of Rev. Rul. 74–590 produced a curious and unbalanced situation. From the time that the charges for the Centrex services were unbundled, all the private communication services were furnished under billing procedures which were virtually identical to those using PBX systems. In addition, the PBX systems provided the same kind of associated services as those provided in connection with the basic Centrex system. Yet, from the date of the passage of the Excise Tax Reduction Act of 1965, until one week before oral argument in this case, the I.R.S. had not collected excise taxes on charges paid for the PBX associated services. This, we feel, was the kind of unequal treatment which provoked Justice Frankfurter's remark that "the Commissioner cannot tax one and not tax another without some rational basis for the difference."

United States v. Kaiser, 363 U.S. 299, 308 (1960), (Frankfurter, J., concurring).

In apparent recognition of the patent imbalance which had been created by these inconsistent rulings, the I.R.S. on May 31, 1977, issued Rev. Rul. 77–189. It was made in response to a request regarding the taxability of dual use accessorial equipment (associated services) used in connection with PBX systems. The ruling recognized that these associated services functioned in the same way and that the charges for their use were billed in the same manner as the Centrex associated services, which were held to be taxable in Rev. Rul. 74–590. The ruling stated that Rev. Rul. 74–590 applied equally to the associated services used in connection with the PBX system and with other similar types of systems which provided both local exchange service and private communication service. Apparently in view of the problem that would be created by applying the ruling retroactively to PBX services, it was stated that the new rule would not be applied with respect to bills rendered after June 18, 1973 (the date of publication of Rev. Rul. 73–270) and before April 1, 1975 (the second calendar quarter beginning after December 9, 1974, the date of publication of Rev. Rul. 74–590).

It is well settled that while revenue rulings may be helpful in interpreting a statute in some cases, they are not binding either on the courts or the Secretary of the Treasury. *Allstate Ins. Co. v. United States*, 209 Ct. Cl. 1, 530 F.2d 378 (1976), and cases cited therein. In this instance we decline to follow the rulings referred to herein, because we think that they constitute unreasonable and erroneous interpretations of the law.

The phrase "necessary or unique" was first included in a bill drafted by the Administration and submitted to Congress by the President.[7] There is nothing in the legislative history which explains the meaning and application of the phrase, so that it is necessary to look to other sources for its interpretation. Plaintiff suggests that the absence of legislative history indicates that the language

[7] The Administration proposal, with explanatory materials, has been printed as H.R. Doc. No. 173, 89th Cong., 1st Sess., 1965.

chosen had a well settled usage which required no further explanation. To support that view, plaintiff calls our attention to court decisions interpreting section 162(a) of the Code, which permits deductions for "ordinary and necessary expenses" incurred in connection with a trade or a business. In several cases, the Supreme Court has interpreted the word "necessary" in section 162 as requiring only that the claimed expenses be appropriate and helpful. *Welch v. Helvering*, 290 U.S. 111, 113 (1933), *Commissioner v. Tellier*, 383 U.S. 687, 689 (1966). In *Tellier*, the Court cited *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 421 (1819), wherein the Supreme Court ruled that the "necessary and proper" clause in Article I of the Constitution does not limit Congress to the enactment of legislation found to be essential, but that the word "necessary" should be interpreted to include legislation which is "appropriate" to a legitimate legislative goal.

To buttress its interpretation of "necessary," defendant cites *Barton Mines Corp. v. Commissioner*, 446 F.2d 981, 991 (2d Cir. 1971), which in construing section 613(c)(2) of the Code held that the word "necessary" means "essential or indispensable."

The different results reached by the courts in *Welch v. Helvering* and *Barton*, may be explained because of the different considerations underlying the provisions of the Code in each case. In *Barton*, the court was seeking to interpret section 613(c)(2) of the Code. It made precise distinctions as to activities which constituted "mining" eligible for a depletion allowance, in contrast to "refining," which was not eligible for such an allowance. In defining "mining," the statute included "any treatment process necessary or incidental thereto." Since it was found that the purpose of the statute was to make precise delineations, the court gave the term "necessary" a narrow interpretation. Moreover, this interpretation was in accord with a Treasury regulation which was promulgated after the case had been tried in the Tax Court.[8]

None of the cases cited by the parties is sufficiently analogous to settle the question, but on other grounds, we

[8] Treas. Reg. § 1.613-3(f)(2)(iii).

have concluded that plaintiff's interpretation more nearly reflects the Congressional intent.

In the first place, we think the adoption of defendant's interpretation of "necessary" would lead to absurd results and render section 4252(d)(2) meaningless. Defendant would tax the charges on all of the equipment provided as associated services if the private communication system could possibly function without the use of the equipment. This would be the result if, as defendant insists, the associated services must be technologically essential to the intercom system. Thus, under defendant's view, the associated services must be an integral part of the private communication systems which are already covered by section 4252(d)(1)(B). If that were true, there would have been no need for Congress to include subsection (d)(2), which defines the associated services.

Obviously, the word "necessary" must be interpreted in its particular context; it must be read in connection with the other provisions of section 4252 and particularly 4252(d)(1)(B), and it must be construed in accordance with results which Congress sought to achieve when the 1965 Act was passed. When this is done, there are persuasive indications that plaintiff's interpretation is correct. For example, extension lines are expressly mentioned in subsection (d)(2) as the kind of associated services which Congress intended to qualify for the exemption. Clearly, extension lines are not technologically essential to the use of the intercommunication system, but there is no doubt that they are "appropriate and helpful" to the use of the system.

That defendant's position is contrary to the statutory language, is further indicated by the inclusion of "switching capacity" as one of the associated services listed in subsection (d)(2). These services, which include switchboards and key sets, are likewise not technologically essential to the functioning of the private intercommunication system because it can be used without them. The same is true of the other associated services involved here.

Moreover, one of the considerations which prompted Congress to enact section 4252 influences us to adopt the definition of "necessary" as found in *Welch v. Helvering*. At

the time Congress was considering passage of the 1965 Act, it was known that private communication companies were manufacturing and selling highly sophisticated intercom equipment which far exceeded what was technologically essential to the basic system. This equipment was similar or identical in function to the associated services in issue. Congress was well aware that these highly advanced pieces of equipment were available for subscriber-owned use and also that the subscriber-owned equipment had always been exempt from the excise tax. The Congressional intent to give telephone company equipment the same tax advantage then allowed subscriber-owned equipment is shown in the Committee reports:

> * * * With the ever-increasing number of varied services which modern science makes it possible for telephone companies to provide, the tax on private communication systems represents a severe competitive handicap to the expanded use of these new and varied services.
>
> For the reasons indicated above, your committee's bill provides an exemption from the tax on local telephone service for private communications service if a separate charge is made for this service. * * * [H. R. Rep.No. 433, 89th Cong., 1st Sess., *reprinted in* 1965 *U.S. Code Cong. & Admin. News* 1677.]

Although it would be possible for a modern-day business to function without the associated services here in dispute, it would be extremely inconvenient and wasteful of the time of its employees to do so. Without a telephone key set, any consumer who desired to use more than one line would have to keep several telephones on his desk, one for each line. A system without blinking lights or "hold" buttons would cause interruptions and disruptions of telephone calls. Therefore, from the standpoint of modern business operations, the associated services are almost as "necessary" as the telephone itself. We think Congress must have been mindful of these circumstances, since it employed the phrase "necessary *to the use of*" a private communication system. This language emphasizes the taxpayer's judgment as to what is or is not necessary—a concept which includes what is appropriate and helpful. *Welch v. Helvering, supra,* at 113.

Secondly, we reject defendant's interpretation because it has been unable to point out to us any "associated services" which would qualify for the tax exemption except those which are integral parts of the basic intercommunication system rather than the separately defined associated services. In Rev. Rul. 74–590, it was held that charges made in connection with an unrestricted Centrex system for dual use equipment such as illumination lights, wink hold relays and hold buttons, were taxable, because the equipment was not "necessary or unique to the use of the private communication service." "Unrestricted service" was defined as an installation which, in addition to providing private communication service, also provides direct access to local telephone service. Although there were separate charges for the private communication system, the local telephone service, and for each article of accessorial (associated services) equipment, the ruling was apparently based on the fact that the associated services equipment was dual use equipment which was used both in connection with the local telephone service and with the private communication system. The only authority cited for the ruling was Situation 2 of Rev. Rul. 73–401, 1973–2 C.B. 363. As that ruling shows, the example cited was a device which was used solely to provide access to local telephone service. Unlike the associated services involved here, it was not dual use equipment and was not used in connection with the private intercommunication system. Obviously therefore, it was not necessary to the use of that system. We think that Rev. Rul. 74–590 is inconsistent with the plain language of section 4252(d)(1), which provides that the private communication service shall be exempt from tax "regardless of whether such * * * intercommunication system may be connected through switching" to local telephone service. Moreover, the Administration bill expressly contemplated that charges for the private intercom system and associated services would not be subject to tax because of their dual use, *i.e.*, their access to or routing through a local exchange. In the President's letter which submitted the Administration bill to Congress, there was an analysis of the provisions of the Administration bill

including the following recommendation for tax exclusion of the charges for "private communication services."

> Under present law, a private communication system (that is, a communication system solely for the use of a single subscriber) is taxable as a general telephone service to the extent it involves telephones that have access outside the private system to a local exchange system. Similarly, a private line is presently taxed as a general telephone service if it is routed through a local exchange. These services, along with associated services which are necessary or unique to such private communication services, constitute "private communication services" as defined in paragraphs (1) and (2) of section 4252(d) of the code, as amended by the bill, if a separate charge is made for such services. * * * Private communications services, as so defined, are exempted from tax under the bill.[9]

Finally, in reaching this decision, we are guided by several well known rules of statutory construction. It is a long-established principle that if there is a serious doubt as to taxability, the doubt should be resolved in favor of the taxpayer. *Allstate Ins. Co. v. United States, supra; Ellis v. United States,* 416 F.2d 894, 897 (6th Cir. 1969); *McFeely v. Commissioner* 296 U.S. 102, 111 (1935). Here, there is such a doubt as to taxability, because the applicable statute contains no definition of the phrase "necessary or unique," and there is virtually no legislative history explaining what Congress intended by it. The doubt is intensified by the fact that although some 12 years have elapsed since the passage of the Excise Tax Reduction Act of 1965, the Secretary has issued no clarifying regulation as authorized by 26 U.S.C. § 7805. This is not a case where the failure to issue a regulation can be attributed to the fact that the meaning of the statute is so clear that there is no necessity for a regulation. The conflicting revenue rulings, to which we have referred, are strong evidence of doubt and confusion by the I.R.S. as to the correct interpretation of the statute.

There is another canon of construction which is even more applicable in this instance. "Where a particular construction will produce inequity and injustice, such a

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[9] H.R. Doc. No. 173, 89th Cong., 1st Sess., 1965, pp. 105–106.

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construction is to be avoided if another and more reasonable interpretation is perceived." *Shattuck v. Gallagher*, 218 F.2d 428, 429 (6th Cir. 1955), *Gellman v. United States*, 235 F.2d 87, 92 (8th Cir. 1956). The unfairness and inequity present in this case are clearly demonstrated by the fact that from the time that Rev. Rul. 73–270 was issued until April 28, 1977, when Rev. Rul. 77–189 was announced, the I.R.S. held that the associated services subscribed to by plaintiff and other Centrex users were taxable, whereas the virtually identical services provided by the PBX system were held to be tax-free. Rev. Rul. 77–189 is in itself a tacit admission of the unequal treatment which had been accorded the taxpayers.

CONCLUSION

In summary we find that the associated services to which plaintiff subscribes meet the requirements of a "private communication" system as defined in section 4252(d) in that these services are both "separately charged" and "necessary * * * to the use" of a private communication system. The charges collected for such associated services are therefore exempt from the excise tax imposed by section 4251. Accordingly, judgment is entered in favor of plaintiff and against defendant for the sum of $28,069.31, with interest thereon as provided by law.

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564 F.2d 66

LODGE 2424, INTERNATIONAL ASSOCIATION OF MACHINISTS AND AEROSPACE WORKERS, AFL-CIO v. THE UNITED STATES

[No. 172–76. Decided October 19, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Civilian pay; labor organization; union dues allotments; discontinuance of allotment.—Plaintiff union seeks to recover certain voluntarily allotted union dues which the Government (Aberdeen Proving Grounds (APG)) deducted from the wages of Mr. Wright, a

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former member of the union. Pursuant to a negotiated agreement, APG was required to deduct dues of union members within the bargaining unit from their pay and to transfer the amounts to the union at stated intervals. Mr. Wright had given his consent to a deduction from his biweekly wages in accordance with the agreed procedure, and up to October 18, 1971, his dues were properly deducted. However, on that date he was transferred to a position outside the bargaining unit, but APG erroneously continued to deduct his dues and to make payment to the union which did not notify APG of Mr. Wright's change in status although the agreement so required. The union continued to retain the excess dues until November 1972, when APG, realizing its error, ceased deducting Mr. Wright's dues and deducted the amount thereof from its December 1972 payment to the union. The December payment covered the aggregate of employee dues deductions for the checkoff period. The union filed a grievance, contending that APG's recoupment violated the agreement which made no provision for recoupment. The arbitrator found that the agreement had been violated and awarded the union the amount in issue. Defendant submitted the matter to the Comptroller General, who ruled that the payments to the union authorized by the agreement had been fully satisfied and that no legal authority existed to pay any additional amount because nothing was due. On request for reconsideration, the Comptroller General again barred defendant from paying the award, holding that the arbitrator exceeded his authority in ordering APG to make a payment for which it was not legally responsible. The court *holds* that it will not enforce the award against the Government, since the award is not mandated by the terms of the bargaining agreement and is contrary to law. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

Court of Claims jurisdiction; generally.

[1] In order to obtain recovery in the Court of Claims, a plaintiff must show some statute, regulation or contractual agreement which entitles it to recover a sum of money from the Government.

Federal Courts ⚖1072

Regulations of Executive Department; binding effect of regulations.

[2] Departmental regulations where issued pursuant to statutory authority have the force and effect of law.

Administrative Law and Procedure ⚖417

Civilian pay; labor organization; union dues allotments; discontinuance of allotment.

[3] The bargaining agreement between plaintiff-union and the Federal Government provided that once a covered employee left the bargaining unit, his union dues deductions were to be discontinued; this provision reflected the policy established by regulations for Government-labor relations. Therefore, any payments made by the Government to the union of dues erroneously deducted by the Government from the salary of an employee permanently transferred outside the unit were illegal.

Labor Relations ⚖104

Opinion of the Court

Offset; Government right of.

[4] The Government has the right to recover by offset or otherwise sums illegally or erroneously paid. Thus, where the Government erroneously and illegally deducted dues from the salary of an employee covered by a collective bargaining agreement after he had transferred from the bargaining unit and made payments thereof to the union, the Government has the right to recover such illegal and erroneous payments by way of setoff against future payments to the union covering dues deducted from employees.

Labor Relations ⚖104

Estoppel; United States Government; unauthorized act of Government agent.

[5] The Government cannot be estopped from recovering by offset or otherwise sums illegally or erroneously paid by the mistake of its officers or agents.

Estoppel ⚖62.2(3)

Civilian pay; labor organization; arbitrator's decision; scope of judicial review.

[6] Since the United States is specifically excluded in the definition of "employer" in the Labor-Management Act, decisions which limit judicial review of and accord finality to decisions of arbitrators made pursuant to collective bargaining agreements, have no applications to agreements between the Government and a union.

Labor Relations ⚖477

Civilian pay; labor organization; arbitrator's award; enforceability.

[7] Where an arbitrator's award against the Government pursuant to a collective bargaining agreement ignored laws and regulations integral to the agreement and binding upon him as equally as on the parties, the award is judicially unenforceable.

Labor Relations ⚖478

William B. Peer, attorney of record for plaintiff. *Barr & Peer,* of counsel.

Lawrence S. Smith, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before COWEN, *Senior Judge,* DAVIS and KUNZIG, *Judges.*

COWEN, *Senior Judge,* delivered the opinion of the court:

Plaintiff brings this action to recover $80.33 of voluntarily allotted union dues, which the Government deducted from the wages of a former member of the union. The case is before us on the parties' cross-motions for summary

judgment, there being no genuine issues of material fact in dispute. For the reasons set forth below, we grant defendant's motion for summary judgment and dismiss the petition.

The facts which give rise to this controversy are relatively simple. Plaintiff, a union, is the sole bargaining agent for a group of Government wage grade employees at the Aberdeen Proving Ground (APG), Aberdeen, Maryland. The union is supported by membership dues, collected through a system of "voluntary allotments" by which the employees in the bargaining unit agree in writing to have a specified sum deducted by the Government from their paychecks. The Government collects all of the members' dues in one lump sum each payday and transmits the sum directly to the union, as provided in Article XXXIX of the Collective Bargaining Agreement between the Government and the Union (hereafter, Bargaining Agreement):

> *Section* 2. The Employer will deduct Union dues from the pay of those eligible employees who voluntarily authorize such deductions * * * who are members of the Union * * * and who are employed within the Unit(s) of wage grade employees certified by the US Department of Labor * * * as exclusively represented by the Union * * *.
>
> * * * * *
>
> *Section* 9. The Employer's payroll office will transmit to the Financial Secretary or Secretary-Treasurer of the Union not later than three (3) workdays after each payday the following:
>
> * * * * *
>
> b. A check drawn on the Treasurer of the United States and made payable to the Union in an *amount equal to the grand total of all such deductions* less two cents for each individual deduction made. [Emphasis added.]

Among plaintiff's members was one Robert L. Wright, an APG employee. As a member of the collective bargaining unit, Mr. Wright had given his written consent to have the Government deduct $2.77 from his biweekly wages in accordance with the above-quoted procedure. The deduction was always properly made and paid by defendant so

long as Mr. Wright was a member of the bargaining unit. However, on October 19, 1971, Mr. Wright was promoted to a position not covered by the Bargaining Agreement. After that time, the Government was no longer authorized to make dues deductions as it had been doing. Article XXXIX, Section 7 of the Bargaining Agreement makes this clear:

> *Section 7.* An employee's voluntary allotment for payment of his regular Union dues will be terminated by the Employer's payroll office with the beginning of the first pay period following the pay period in which any of the following occur:
>
> * * * * *
>
> b. Transfer of the employee authorizing dues deduction outside of the unit (Except for temporary promotion or detail).

However, when Mr. Wright was promoted out of the bargaining unit, the Government failed to end the dues deduction and continued to make the payments to the plaintiff union. The union did not notify the Army payroll office of Mr. Wright's change in status, although it was required to do so under the Bargaining Agreement[1]. The union continued to retain the excess dues and did not offer to return them to the Government.[2]

In November 1972, the Government apparently realized the error of its ways and ceased making the dues deductions from Mr. Wright's wages. It then determined the amount that had been incorrectly paid to the union and deducted the sum ($80.33) from its December 1972 payment to the union covering the aggregate of employee dues deductions for that month. The union objected to this "recoupment" procedure. It argued that under Section 9 of Article XXXIX of the Bargaining Agreement, there was no provision for recovery of a previous dues overpayment, and therefore the $80.33 had been illegally withheld from the

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[1] Article XXXIX, Section 8 of the Bargaining Agreement reads:

"The Union is responsible for promptly notifying, in writing, the Employer's payroll office when any member of the Union is expelled or for any reason ceases to be a member in good standing."

[2] There is evidence that at least by May 22, 1972, the union president had been given notice of the change in Mr. Wright's status; the president had received a list of employees who were changing positions. Defendant's Brief at p. 8.

December 1972 payment. *See* Article XXXIX, Section 9, *supra*.

The union sought to resolve the matter by invoking the grievance and arbitration procedure established under the Bargaining Agreement, Articles XXVII and XXVIII.[3] On August 3, 1973, the arbitrator issued his decision upholding the union's position. Although he found that the $80.33 had been improperly deducted and paid to the union by mistake, the arbitrator ruled that the "self-help" remedy resorted to by the defendant in recouping the $80.33 was an "improper procedure," which violated the provisions of the Agreement. The opinion concluded:

> * * * Whether or not the Employer may have other avenues for recoupment has not been considered by the Arbitrator. His opinion is limited to a finding that the particular method used in the instant case violated the provisions of the Collective Bargaining Agreement.

The defendant did not pay plaintiff the sum awarded by the Arbitrator. Rather, the Government disbursing officer submitted the question to the Comptroller General as permitted by 31 U.S.C. §§ 74 and 82(d). On October 1, 1974, the Comptroller General issued Opinion B–180095, ruling that the Government could not legally comply with the arbitrator's award. The decision stated in part:

> It is a basic principle of law and commerce that a payee is not entitled to be paid by a payor any more money than is due. So where by mistake of fact at an earlier time a payee is paid more on an obligation than he is due, the payor may rightfully adjust subsequent payments to compensate for such overpayments or advancement of funds, so that the payee may not be unjustly enriched. 70 C.J.S. *Payment* section 157 (1951).
>
> Therefore, we have concluded that the payments authorized under the agreement have been fully satisfied. Thus, no authority exists to pay any additional amount, notwithstanding the arbitration award.

Upon receipt of this decision, the union filed an unfair labor practice complaint with the Assistant Secretary of Labor for Management Relations, alleging that the defendant had violated sections 19(a)(1) and (6) of Executive Order

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[3] Plaintiff's Exhibit 1, at pp. 32–34.

11491 as amended, 3 C.F.R. 254 (1974), by neither complying with the Arbitrator's award nor seeking review by the Federal Labor Relations Council. The Assistant Secretary of Labor ruled that although an unfair labor practice may have existed, there remained a question whether the Army had authority to pay the arbitrator's award in view of the Comptroller General's decision barring payment. The union then requested the Comptroller General to review and reconsider the earlier decision.

On April 30, 1975, the Comptroller General issued a second decision (B–180095, 54 Comp. Gen. 921), again barring the defendant from paying the arbitrator's award. In this decision, the Comptroller General noted that 31 U.S.C. § 628 (1970) prohibited payment of Federal funds except "pursuant to law." Thus, the decision continued:

> It was therefore not legally permissible for the agency to pay over to the union a sum amounting to $80.33 more than it was indebted to the union for. Accordingly, the arbitrator exceeded his authority in ordering the agency to make a payment for which it was not legally responsible.

The union then brought suit in this court to enforce the arbitrator's award.

I.

Although they agree on the facts, the parties differ in their statements of the issues of law. Plaintiff would have us view the question as the arbitrator viewed it: "[W]hether the Employer may, in effect, use self help to rectify its own mistake." [*In the Matter of Arbitration Between ABERDEEN PROVING GROUND DEPARTMENT OF THE ARMY and INTERNATIONAL ASSOCIATION OF MACHINISTS AND AEROSPACE WORKERS AFL-CIO LOCAL 2424*, FMCS File No. 73K/09938, (August 3, 1973).]

Defendant, on the other hand considers this formulation of the issues as too narrow and simplistic. Defendant's view of the issue may be paraphrased as whether the court may enforce an arbitrator's award against the Government when the award is not mandated by the terms of the Bargaining Agreement and is contrary to law. As a

secondary defense, defendant asserts that the court has no jurisdiction of the claim, but we find that it is not necessary to reach this question.[4] We agree with defendant's formulation of the issue and conclude that as a matter of law, plaintiff is not entitled to recover.

It is so evident as scarcely to require acknowledgment, that in order to obtain recovery in this court, a plaintiff must show some statute, regulation or contractual agreement which entitles it to recover a sum of money from the Government. 28 U.S.C. § 1491. This requirement means that the plaintiff must show that it is entitled to the $80.33 which was erroneously paid to it after Mr. Wright's transfer and subsequently withheld by the Government from a later payment due the union. Clearly, the plaintiff has failed to show any such entitlement.

It was an integral part of the Bargaining Agreement between the union and the Government that once an employee left the bargaining unit, his dues "check-off" was to be discontinued. As indicated above, section 7b of Article XXXIX of the Bargaining Agreement specifically required that the dues check-off be terminated as soon as an employee was transferred out of the unit. This was not a precatory or advisory contractual provision; rather it was a binding requirement mandated by regulation. Department of Defense Directive 1426.1, VIII B.1.b (March 26, 1970) required that *all* such agreements for withholding union dues should contain the following provision:

> That an allotment shall be terminated when the employee leaves the unit as a result of resignation, retirement, transfer, or other separation from the rolls of the activity, reassignment, promotion (except temporary promotion), or other personnel action; when the dues withholding agreement between the activity and the labor organization is suspended or terminated; or when the employee has been suspended or expelled from the labor organization * * *

The requirement set forth in this regulation is, moreover, reflective of an established policy throughout Govern-

[4] Much of the briefs of the parties has been devoted to the jurisdictional issue, but we defer decision on this question because it is clear that plaintiff has no case on the merits. *Travis v. United States*, 199 Ct. Cl. 67, 70, n. 1 (1972). However, on the jurisdictional issue, *see Bendure v. United States*, 213 Ct. Cl. 633, 554 F.2d 427 (1977).

ment-labor relations. The Federal Personnel Manual (FPM) provides that the allotments of dues from an employee's pay shall be terminated when the employee "moves or is reassigned * * * to an organizational segment for which the labor organization has not been accorded exclusive recognition." FPM, Book 550, Subchapter S3–6(a) (Nov. 18, 1970). Civil Service Commission Regulations contain a similar requirement. *See* 5 C.F.R. § 550.322(c). And Executive Order 11491 provides that a dues allotment terminates when "the dues withholding agreement between the agency and the labor organization * * * ceases to be applicable to the employee." Exec. Order No. 11491, § 21(a)(1), 34 Fed. Reg. 17614 (October 31, 1969).

There is no question that the cited regulations were issued pursuant to statutory authority and had the force and effect of law. Allotments and assignments of civilian employees' pay are authorized by 5 U.S.C. § 5525. 5 U.S.C. § 5527, which is a part of the same basic statute, provides that the President and the head of each agency concerned shall prescribe and issue regulations appropriate for carrying out the provisions relating to the allotment of employees' pay. On January 2, 1962, the President issued Executive Order 10982, 27 Fed. Reg. 3. It provided that the Civil Service Commission was authorized to perform the statutory functions relating to the allotments and assignments of employees' pay. Thereafter, the Civil Service Commission issued the regulation which provides that any agreement between the union and the Government regarding deductions from employees' pay must include the provision that the allotment be discontinued when the employee is transferred out of the bargaining unit covered by the agreement.

Moreover, Executive Order 11491, pursuant to which the collective bargaining agreement was executed, expressly provided that the regulations referred to above would apply to that agreement. Section 12(a) of the Order reads as follows:

> Sec. 12. *Basic provisions of agreements.* Each agreement between an agency and a labor organization is subject to the following requirements—

(a) in the administration of all matters covered by the agreement, officials and employees are governed by existing or future laws and the regulations of appropriate authorities, including policies set forth in the Federal Personnel Manual; by published agency policies and regulations in existence at the time the agreement was approved; and by subsequently published agency policies and regulations required by law or by the regulations of appropriate authorities, or authorized by the terms of a controlling agreement at a higher agency level; * * * . [34 Fed. Reg. 17611, (1969).]

Since the law, as provided in the regulations, required a termination of the dues allotment upon Mr. Wright's transfer, the payments made by the Government thereafter were both erroneous and illegal.

Therefore, the only question remaining is whether the manner in which the Government recouped the illegal payment was authorized. We note first that there is nothing in the Bargaining Agreement which bars the Government from resort to such a "self-help" procedure. Despite the reliance of the arbitrator and plaintiff on Article XXXIX, Section 9 of the Agreement, that section does not specifically prohibit the action taken by defendant. Although section 9 requires that the Government pay the union a "check * * * in the amount equal to the grand total of all such [dues] deductions," we think that this provision is intended to guarantee payment only of the dues *to which the union is entitled.* We cannot read it to mean that the union is entitled to retain dues which were improperly deducted from the employee's wages and mistakenly paid to the union.

Whereas there was nothing in the Bargaining Agreement forbidding the deduction made by defendant, such a "self-help" procedure was specifically authorized by Army regulations. Army regulation 37–105, para. 10–118, dated August 12, 1966, reads as follows:

> * * * Adjustment to correct amounts erroneously withheld or where through error withholdings have not been made from the salary of a currently employed individual will be made on a subsequent payroll on which the employee's name appears.
>
> * * * * *

* * * Appropriate entries will be made on the listing forwarded to the employee organization.

Few principles are so well established as the right of the Government to recover by offset or otherwise sums illegally or erroneously paid. Moreover, it cannot be estopped from doing so by the mistakes of its officers or agents. *Wisconsin Central RR v. United States*, 164 U.S. 190, 211–12 (1896); *United States v. Munsey Trust Co.*, 332 U.S. 234, 239–40 (1947); *Fansteel Metallurgical Corp. v. United States*, 145 Ct. Cl. 496, 499–500, 172 F. Supp. 268, 271 (1959). Therefore, the means which the Government took to recover the illegal payment were not only authorized by the regulations but sanctioned by these well settled rules of law.

II.

In an effort to avoid the difficult obstacle presented by the cited regulations, plaintiff maintains that judicial review of an arbitrator's decision is a limited one and that the court must enforce an arbitrator's award where the arbitrator does not "exceed the scope of his authority." In support of this position, plaintiff cites a long line of cases, including *United Steelworkers of America v. U.S. Gypsum Co.*, 492 F.2d 713 (5th Cir. 1974), *reversing* 339 *F. Supp.* 302 *(N.D. Ala. 1971); United Steelworkers of America v. Enterprise Wheel and Car Corp.*, 363 U.S. 593 (1960); *United Steelworkers of America v. Warrior & Gulf Navigation Co.*, 363 U.S. 574 (1960); *United Steelworkers of America v. American Mfg. Co.*, 363 U.S. 564 (1960). However, we reject plaintiff's argument because we find that the authorities cited are inapposite to the facts of this case. *See Byrnes v. United States*, 213 Ct. Cl. 675 (1977).

In the first place, the cases cited by plaintiff all concern labor arbitration awards made in the context of private labor disputes. Those decisions focus on the Congressional intent, as reflected in the Labor-Management Relations Act, 29 U.S.C. § 141, *et seq.*, 61 Stat. 136, that industrial labor disputes be settled by arbitration. However, the definition of "employer" in the Labor-Management Act specifically excludes the United States, 29 U.S.C. §§ 142(3)

and 152(2). Consequently, those cases, which limit judicial review and accord finality to decisions of arbitrators, including their construction of provisions of collective bargaining agreements, have no application to an arbitrator's decision made pursuant to a collective bargaining agreement between the Government and a union.

In the second place, we cannot agree with the plaintiff's contention that the arbitrator "did not exceed the scope of his authority" in awarding the $80.33 to the union. On the contrary, we find that he based his decision on a literal reading of one section of the collective bargaining agreement and ignored laws and regulations which were an integral part of that agreement and binding upon him as equally as on the parties. Since the decision was contrary to law, it cannot be upheld.

CONCLUSION

It follows from what is said above that plaintiff's motion for summary judgment should be denied; defendant's cross motion for summary judgment should be granted, and plaintiff's petition should be dismissed. It is so ordered.

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563 F.2d 1019

BERNERD C. KINGSBURY, JR. v. THE UNITED STATES

[No. 245–74. Decided October 19, 1977]

ON THE PROOFS

Assignment of Claims Act; satisfaction of tax lien; community property; marijuana smuggling operations.—Plaintiff seeks to recover funds seized by the FBI from his daughter-in-law upon her arrest after she aided in the escape from prison of plaintiff's son. The son was convicted of illegal importation of marijuana. The Government applied the seized funds to satisfy a fine imposed on the son for smuggling marijuana and a jeopardy tax assessment against him on account of income believed to have been derived from smuggling. During the son's confinement, plaintiff provided substantial loans to the wife (who was on probation following her conviction for aiding him in an escape attempt), and contends that the funds were the wife's

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separate property and that in repayment of the loans she executed a sworn assignment to plaintiff of her rights to part of the seized funds. The assignment was made just prior to the son's second escape from prison with his wife; both are fugitives from justice. It is *held* that the assignment on which plaintiff sues is void under the Anti-Assignment Act and that the seized money in the hands of plaintiff's daughter-in-law was under California law properly subjected to satisfaction of obligations of her husband. Plaintiff is not entitled to recover and the petition is dismissed.

Court of Claims jurisdiction; generally.

[1] Since the United States is the owner of the subject seized funds by virtue of a levy and execution, the present action is not an action against a specific res; this court does not have jurisdiction of a claim *in rem* but does have jurisdiction over a claim *in personam* against the United States to recover a sum of money.

Federal Courts ⚖1085

Court of Claims jurisdiction; contract claims; contracts implied in fact.

[2] An action to recover money resulting from a levy on funds used to pay the taxes and criminal fine of another may be assumed to be within the jurisdiction of this court as one founded upon a contract implied in fact.

Federal Courts ⚖1077

Assignment of Claims Act; generally.

[3] The Anti-Assignment Act seeks to prevent persons of influence from buying up claims which might then be improperly urged upon Government officials; to prevent possible multiple payment of claims and avoid the necessity of an investigation of alleged assignments by permitting the Government to deal only with the original claim; and to preserve for the Government defenses and counterclaims which might not be available against an assignee.

United States ⚖111(2)

Assignment of Claims Act; claims subject to operation of Act.

[4] A case intended to be reached by the Anti-Assignment Act is the instant case where the Government seized funds from plaintiff's daughter-in-law at the time of her arrest for aiding plaintiff's son to escape from prison and applied those funds to satisfy taxes and a criminal fine of the son, and the daughter-in-law subsequently assigned the funds to plaintiff on the eve of her and the son's flight from justice.

United States ⚖111(3)

Husband and wife; community property; obligation of one party for debts of other.

[5] Under California law, all property, real or personal, acquired during the marriage by a married person, is community property and subject to the debts of the other. Under the facts of this case, where Federal agents seized money from the wife upon her arrest and thereafter applied the money to satisfy taxes and a criminal fine of her husband, the seized money was community property, whether or not the

husband's obligations were premarital debts or not. No distinction is to be made for execution in enforcement of a fine imposed on a husband's criminal conviction.

Husband and Wife ⚖268(2)

Jesse D. Miller, attorney of record, for plaintiff. *Miller & Mandel*, of counsel.

James L. Malone, III, with whom was *Acting Assistant Attorney General Myron C. Baum*, for defendant. *Theodore D. Peyser*, of counsel.

Before DAVIS, NICHOLS and KASHIWA, *Judges*.

PER CURIAM: This case comes before the court on defendant's motion, filed June 17, 1977, requesting that the court adopt, as the basis for its judgment in this case, the recommended decision of Trial Judge David Schwartz, filed April 25, 1977, pursuant to Rule 134(h), plaintiff having filed no intention to except thereto and the time for so filing pursuant to the Rules of the court having expired. Upon consideration thereof, without oral argument, since the court agrees with the trial judge's recommended decision, as hereinafter set forth,* it hereby grants defendant's motion and affirms and adopts the said decision as the basis for its judgment in this case. Therefore, it is concluded that plaintiff is not entitled to recover and the petition is dismissed.

OPINION OF TRIAL JUDGE

SCHWARTZ, *Trial Judge:* Plaintiff, Dr. Bernerd C. Kingsbury, Jr., sues for $37,100, a portion of the sum seized by the Government from plaintiff's son and daughter-in-law, Bruce and Valerie Kingsbury, and thereafter applied to the satisfaction of a fine imposed on Bruce Kingsbury for smuggling marijuana and a jeopardy tax assessment against him on account of income believed to have been derived from smuggling. The basis of the claim is that the

* Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed April 25, 1977, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

money seized was Valerie Kingsbury's separate property and that she has assigned her rights to plaintiff. The suit fails for the reasons of law discussed below, among them the invalidation of the assignment by the Anti-Assignment Act, 31 U.S.C. § 203 (1970).

Bruce Kingsbury was arrested on October 19, 1971, and charged with the illegal importation of marijuana. He married Valerie Nelson Kingsbury in March 1972. On June 26, 1972, Bruce pleaded guilty, was fined $15,000 and sentenced to 4 years confinement at the Federal Correctional Institute (FCI) at Lompoc, California.

On September 5, 1972, the Internal Revenue Service made a jeopardy assessment against Bruce in the amount of $100,305.75, on the basis of a determination that he did not report $148,568.70 in income derived from illegal smuggling operations in 1971. Later that month, Bruce learned from his Parole Board that he would not be considered for parole for 2 years. Thereupon, he and his wife planned his escape from prison.

On October 10, 1972, Bruce escaped from the FCI. He drove an FCI vehicle to a prearranged destination, where he met Valerie, who was driving an automobile. Bruce entered Valerie's automobile but before they could leave they were stopped and arrested. Shortly thereafter, FBI agents seized $6,230 in U.S. currency and $87 in Canadian currency from the vehicle in which Bruce and Valerie were apprehended. The agents also obtained from Valerie's purse two money bands containing $35,900 in U.S. currency, making a total seizure of $42,130 in U.S. currency and $87 in Canadian currency.

On November 2, 1972, the Internal Revenue Service served upon the FBI a notice of levy on the seized money to collect on the mentioned assessment. On November 28, 1972, the United States District Court for the Southern District of California issued a writ of execution against the seized money to collect the $15,000 fine imposed upon Bruce. On March 21, 1973, the FBI paid $15,000 in response to the district court's writ and $27,216.56 in response to the notice of levy. The entire sum seized was thereby exhausted.

Prior to the escape and during the period of Bruce's confinement at the FCI, the plaintiff provided substantial financial assistance to his daughter-in-law Valerie. He paid Valerie's attorney's fees, lent her $2,618 for the purchase of a Datsun pickup truck and (it is assumed without deciding)[1] also lent her $30,000 in cash pursuant to a plan that she would start an employment agency.

Both Bruce and Valerie pleaded guilty to charges based on the escape. Valerie, who was expecting a child, was placed on probation. Bruce's sentencing was deferred and he was committed to the Federal Community Treatment Center in Los Angeles so that he could be near his wife. Their child was born early in February 1973.

On February 12, 1973, Valerie executed before a notary public a document entitled "Assignment," by which she assigned to the plaintiff, her father-in-law, all her "right title and interest in the sum of $37,100.00, part of a larger sum of approximately $42,000.00" seized on her arrest on October 10, 1972, "in repayment for a $30,000.00 loan given me on or about August 16, 1972" and other lesser loans and advances. Eight days later, on February 20, 1973, Bruce escaped from the Federal Community Treatment Center, and disappeared with his wife and child. Both Bruce and Valerie Kingsbury have remained fugitives from justice, through the time of the trial of this case.

Plaintiff sues as Valerie's assignor. To recover, plaintiff must show, as he contends: (1) that his claim is not barred by the Anti-Assignment Act, 31 U.S.C. § 203 (1970), and (2) that the money seized on October 10, 1972 was Valerie's

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[1] The Government in its post-trial papers does not seem to contest the fact of the loan. Nevertheless, resolution of the factual question of the making of the loan is not necessary for adjudication of the case. Even giving plaintiff the benefit of an assumption that the loan was made, the claim fails for the reasons of law discussed in the text.

The Government also argues that plaintiff has failed to meet his burden of proving by a preponderance of the evidence that the money seized was not Bruce Kingsbury's separate property, consisting, for instance, of hidden profits from the smuggling operations. The detailed findings which accompany this opinion show that Bruce Kingsbury had access to substantial funds and thus that the seized money or at least a substantial part of it may well have been his separate property. No finding is therefore indicated that the seized money was Valerie's separate property. However, once it is assumed that the $30,000 loan was made, it seems more likely than not that the seized money included at least some of the loan proceeds.

separate and lawful property, which could not be used to satisfy either the notice of levy or the writ of execution aimed at the property of Bruce Kingsbury. For the reasons which follow, it is held that both contentions fail.

I

The Invalidation of the Assignment by 31 U.S.C. § 203

The Anti-Assignment Act, 31 U.S.C. § 203 (1970),[2] nullifies assignments of claims against the United States which do not fulfill certain stated requirements. Several of the requirements are not met by the assignment from Valerie Kingsbury to the plaintiff. The Act makes the assignment "absolutely null and void" unless "freely made and executed in the presence of at least two attesting witnesses." The document in evidence bears only the signatures of Valerie Kingsbury and a notary public. The two indispensable witnesses are lacking.

Further, an assignment of a claim, to avoid nullification by the statute, must be made "after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof." *See* 3 WILLISTON ON CONTRACTS § 417 (3d ed. 1960). No claim has here been allowed. Indeed, a claim is only now being litigated; the amount has not been the subject of "ascer-

[2] The relevant portion of the Act reads as follows:

"All transfers and assignments made of any claim upon the United States, or of any part or share thereof, or interest therein, whether absolute or conditional, and whatever may be the consideration therefor, and all powers of attorney, orders, or other authorities for receiving payment of any such claim, or of any part or share thereof, except as hereinafter provided, shall be absolutely null and void, unless they are freely made and executed in the presence of at least two attesting witnesses, after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof. Such transfers, assignments, and powers of attorney, must recite the warrant for payment, and must be acknowledged by the person making them, before an officer having authority to take acknowledgments of deeds, and shall be certified by the officer; and it must appear by the certificate that the officer, at the time of the acknowledgment, read and fully explained the transfer, assignment, or warrant of attorney to the person acknowledging the same. * * *"

Exceptions, not here relevant, were made by Congress in 1940 for assignments to financial institutions and by case law for various types of assignments held to have taken place by operation of law. *See United States* v. *Aetna Surety Co.*, 338 U.S. 366 (1949).

tainment"; and of course no warrant for payment has been issued to the Treasury.

Plaintiff attempts to avoid the Act by advancing alternative arguments: first, that the suit is not a claim against the United States within the intendment of the Act; and, second, that the rationale of the Act would not be defeated by holding it inapplicable to the suit.

The first argument—that the suit is not one on a claim against the United States—assumes that the money was the separate property of Valerie Kingsbury (an assumption challenged in the second part of this opinion). The contention seems to be that since the Government had no claim against the separate property of Valerie Kingsbury and was or is only a custodian of the seized money, her claim to the money is not a claim against the United States but is rather a claim for and against a specific res. In support, plaintiff relies on *United States* v. *$22,993.00 In Currency,* 332 F. Supp. 1277, 1279 (E.D. La. 1971), which holds that a claimant to ownership of property may assign his interest without hazard from the Anti-Assignment Act, where the United States merely seizes property, taking only custody, and does not acquire ownership.

In that case, the United States Marshal had custody of property which had been seized by the United States under the internal revenue laws and for whose forfeiture the Government had brought suit. Intervening claimants to ownership assigned a part of their claim to their attorneys in payment of legal fees. The United States then made a jeopardy assessment for taxes against the claiming owners and served a notice of levy on the Marshal. The court held that since the property seized was not contraband and thus the United States had not by the seizure vested ownership of the property in itself, the claimants to ownership were proceeding against the res and not making a claim against the United States when they intervened, but were asserting a claim against the res itself. They could therefore assign their claim without complying with the Anti-Assignment Act.

The decision relied on the status of the assignor as the claimant to a res of which the United States was not yet the owner. Here the situation is the opposite. The United

States is now the owner of the seized money; there is no res in dispute; and the claimant-plaintiff is surely making not a claim *in rem* but a claim *in personam* against the United States, if for no other reason than that the jurisdiction of this court is limited to money claims against the United States. 28 U.S.C. § 1491 (Supp. V 1975); *United States* v. *Testan*, 424 U.S. 392, 397–98 (1976); *United States* v. *King*, 395 U.S. 1, 5 (1969). A judgment for plaintiff would be a judgment *in personam* against the United States, payable by the Treasury from an appropriation for judgments, upon certification by the court and settlement by the General Accounting Office. 28 U.S.C. § 2517 (1970), 31 U.S.C. § 724a (1970).

Plaintiff's claim falls within the jurisdiction of this court as one upon a contract implied in fact, as in *Kirkendall* v. *United States*, 90 Ct. Cl. 606, 31 F. Supp. 766 (1940), a decision recently approved in *Fidelity & Casualty Co.* v. *United States*, 203 Ct. Cl. 486, 493, 490 F.2d 960, 963–64 (1974) and *Economy Plumbing & Heating Co.* v. *United States*, 200 Ct. Cl. 31, 38–39, 470 F.2d 585, 590 (1972). *Kirkendall* held a contract to be implied from a wrongful seizure of the money of plaintiff to satisfy the tax debts of another. It may be assumed that the rationale of that case would permit jurisdiction of the present suit as one for breach of a contract implied from a levy on money of the plaintiff used to pay the taxes and criminal fine of another.

There is thus no res present in this case, such as there was in *United States* v. *$22,993.00 In Currency*, *supra*. The money whose seizure is the origin of the present case became the property of the United States, by virtue of a levy and execution which came before the assignment—the converse of the situation in the cited case.

This court does not have jurisdiction of a claim *in rem* or of claims generally for specific relief. *United States* v. *Jones*, 131 U.S. 1 (1889). Congress has consented to suits *in rem* against the United States only in courts other than this one. 28 U.S.C. §§ 1444, 2410 (1970) (foreclosure); 28 U.S.C. §§ 1347, 2409 (1970) (partition); 28 U.S.C. § 2409a (Supp. V 1975) (quiet title); I.R.C. 1954 § 7426(a), as amended (wrongful levy); 43 U.S.C. § 666 (1970) (water rights).

Plaintiff thus fails in his contention that he is claiming against a res and not against the United States. Next, or in the alternative, plaintiff contends that the underlying rationale of the Anti-Assignment Act would not be defeated by allowing this suit to proceed. Not so.

The Act has three basic objectives: first, to prevent persons of influence from buying up claims which might then be improperly urged upon Government officials; second, to prevent possible multiple payment of claims and avoid the necessity of the investigation of alleged assignments by permitting the Government to deal only with the original claimant; and third, to preserve for the Government defenses and counterclaims which might not be available against an assignee. *United States* v. *Shannon*, 342 U.S. 288, 291–92 (1952); *United States* v. *Aetna Surety Co., supra*, 338 U.S. at 373.

If Valerie Kingsbury has a claim for the money now sought by her father-in-law, she may of course sue on it. But the statute protects the Government from responding to others than Valerie Kingsbury, on her claim. Were plaintiff allowed to sue, the assignment would have to be investigated in the absence of its maker and the Government might have to face a future suit by the author of the assignment. Were Valerie Kingsbury to sue on her own claim, her testimony might be helpful to the Government on the questions which have not been decided but which might decide the case differently. Note 2 above. A minimum case surely intended to be reached by the Act is that of an assignment made by a convicted criminal on the eve of her flight from justice. In any event, and whatever be the setting, the Act protects the Government from responding to Valerie's claim in a suit by her father-in-law, with whom the Government is not in privity.

The plaintiff's contention that none of the policy considerations underlying the Act are affected by this action must be rejected. The assignment is barred by the Act and the suit fails.

II

The State Law Issue

As an alternative ground for decision, it is held that even if the assignment to plaintiff were good and effective, the money in the hands of Valerie Kingsbury, though loaned to her as claimed by plaintiff, was nevertheless community property under California law and as such subject to the Government's claims against Bruce Kingsbury. The California Code creates a statutory presumption that property acquired during marriage is community property (12A Cal. Civ. Code § 5110 (West))[3]:

> All other real property situated in this state and all other personal property wherever situated acquired during the marriage by a married person while domiciled in this state, and property held in trust pursuant to Section 5113.5, is community property; but whenever any real or personal property, or any interest therein or encumbrance thereon, is acquired by a married woman by an instrument in writing, the presumption is that the same is her separate property * * *.

The exception in the quoted statute for property acquired by a married woman "by an instrument in writing" is here inapplicable because no note or other writing marked the loan from plaintiff to Valerie Kingsbury. Other explicit exceptions, in a closely related section of the California Code, are made for property acquired by gift, bequest, devise, or descent. 12A Cal. Civ. Code § 5107 (West). These, too, have no application on the facts of this case.

The statute does not exempt from the presumption property acquired with borrowed money, without a writing. Accordingly, the California courts have construed property obtained through borrowing as constituting community property unless the loan is made on the faith of existing separate property belonging to a spouse. *Moulton* v. *Moulton*, 182 Cal. 185, 189, 187 Pac. 421, 422 (1920).

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[3] Section 5110 of the California Civil Code was amended, effective January 1, 1975, in the course of a statutory equalization of the status of husband and wife in community property law. The relevant statutory law, for purposes of this case, was that in effect in 1972 and 1973 at the time of the operative facts.

Plaintiff relies on *Hogevoll* v. *Hogevoll*, 59 Cal. App. 2d 188, 138 P.2d 693 (1943), to support a contention that his loan to Valerie Kingsbury was extended on her personal credit, and thus must be considered her separate property. *Hogevoll* involved a purchase of real property by the wife, in which the deed of purchase named the wife alone as the grantee, a fact which in itself establishes a presumption of separate property under the exception for transactions accomplished by instruments in writing. The "primary presumption" of separate property arising from the fact that the deed named the wife as grantee, the court held, "cannot be overcome by a mere showing that the property was purchased by a loan. The husband must further show that the loan was made on the credit of the community property * * *." 59 Cal. App. 2d at 196, 138 P.2d at 698.

The court concluded that the husband failed to prove that the loan was made on the credit of the community; the spouses were living separate and apart at the time of the loan, and no confidential relation existed between them. Evidence supporting the conclusion of separate property was that the wife's half-brother was the source of the loan to the wife for the purchase of the property.

The facts in the instant case dictate a contrary result. The lender was not a blood relative of the borrower-wife, but rather the father of the husband. The lender's own testimony warrants the conclusion that, in making the loan, he was motivated by the dual desire to aid his daughter-in-law, the borrower, and to benefit his son, the borrower's husband. The loan was thus designed to benefit the community of the two, Bruce and Valerie, and not to help Valerie, separately.

Plaintiff testified, moreover, that he thought Valerie to be destitute at the time of the making of the loan. Thus it cannot be said that in making the loan he relied on her existing separate property. Plaintiff made the loan to Valerie on the credit of the community. Finally, such evidence as there is of Valerie Kingsbury's own view of the ownership of the seized money tends to support the conclusion that it was community property. The written report of the FBI interview with Valerie Kingsbury at the time of her arrest states that "[s]he stated that the

currency was the property of she and her husband and was not illegally obtained."

From the foregoing, it is concluded that plaintiff has failed to rebut the application to the seized money of the statutory presumption, quoted above, of section 5110 of California law that "[a]ll other real property situated in this state and all other personal property wherever situated acquired during the marriage by a married person while domiciled in this state * * * is community property." The seized money is held to be community property under the California law.

The wife's interest in community property in California is subject to the tax debts of her husband. In *Cancino* v. *United States*, 196 Ct. Cl. 568, 577, 451 F.2d 1028, 1034 (1971), *cert. denied*, 408 U.S. 925 (1972), this court held that "[u]nder California law, all community property, including the wife's interest, is subject to the debts of the husband, and no distinction is drawn between a husband's separate and community debts."

The taxes owing by Bruce Kingsbury were due for tax year 1971. Bruce and Valerie Kingsbury were married on March 9, 1972. The $15,000 fine was imposed on June 26, 1972 and the jeopardy assessment was made on September 5, 1972. The notice of levy was issued by the IRS on November 2, 1972. It makes no difference, in terms of the result, whether Bruce Kingsbury's obligations to the court and the IRS were premarital debts or not. For under California law even a premarital debt of the husband may be satisfied from community property. In *Weinberg* v. *Weinberg*, 67 Cal. 2d 557, 563–64, 63 Cal. Rptr. 13, 15, 432 P.2d 709, 711 (1967), the California Supreme Court held that premarital creditors of the husband may satisfy their claims from community property assets. The policy of protection of the husband's creditors was explicitly held to outweigh the need for protection of family income, even from premarital creditors of the husband.

That policy has been applied to tax debts, in *Babb* v. *Schmidt*, 496 F.2d 957 (9th Cir. 1974), in which the court held bank accounts constituting California community assets to be subject to a tax lien for the husband's premarital tax debts. A tax obligation and lien thus

reaches the wife's community one-half interest in the property where the lien is for taxes owed by the husband before the marriage. There is no distinction to be made for execution in enforcement of a fine imposed on a criminal conviction.

In sum, the assignment on which plaintiff sues is void under the Anti-Assignment Act and, as well, the seized money in the hands of plaintiff's assignor was under California law properly subjected to satisfaction of obligations of the assignor's husband. The petition must be dismissed.

CONCLUSION OF LAW

Upon the findings and the foregoing opinion, which are adopted by the court, the court concludes as a matter of law that plaintiff is not entitled to recover, and the petition is dismissed.

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565 F.2d 663

ROBERT R. BOLDING v. THE UNITED STATES

Nos. 345–73 and 348–73

ROBERT DEWEY McMILLAN, JR. v. THE UNITED STATES

Nos. 346–73, 349–73 and 351–73

MILBURN R. VERNOR v. THE UNITED STATES

No. 347–73
[Decided November 16, 1977]

ON THE PROOFS

Taxes; employment taxes; failure to pay over taxes; responsible officer; willfulness; penalty.—Plaintiffs seek refund of token payments they made after they were assessed 100% penalties as corporate officers for their alleged willful failure to pay over FICA and income withholding taxes on wages paid to the employees of the subject corporations. Defendant has counterclaimed for the balance of the assessments. For the reasons set forth, it is *held* that plaintiff Bolding

Syllabus

was a responsible person within the meaning of Sec. 6671(b) of the Internal Revenue Code of 1954 who was required to collect, truthfully account for and pay over the payroll taxes from said corporations, that he willfully failed to do so and is therefore liable for the penalties assessed against him pursuant to Sec. 6672 of the Code, that he is not entitled to recover the penalties paid and that defendant is entitled to recover against him on its counterclaim those still unpaid with the amount of such recovery and ultimate dismissal of Bolding's petitions to be accomplished in further proceedings under Rule 131(c). It is also *held* that plaintiff McMillan, although a responsible person, did not act willfully in regard to the corporations' failure to pay the payroll taxes, that he is not liable, that he is entitled to recover the amount he paid, and that defendant's claim against him is dismissed. It is also *held* that plaintiff Vernor was not a responsible person in regard to the failure of Vernor Mfg. Co. to pay the payroll taxes, that he is not liable, that he is entitled to recover the amount he paid, and that defendant's counterclaim against him is dismissed. The amount of plaintiffs McMillan's and Vernor's recovery will be determined pursuant to Rule 131(c).

Taxes; employment taxes; deduction of tax from wages; withheld tax as credit to employee.

[1] Under the system of withholding taxes provided by the Internal Revenue Code, employees are entitled to credit for the amounts of FICA and income taxes withheld from their wages regardless of whether or not the employer turns the funds over to the Government.

Internal Revenue ⚖1766.3

Taxes; employment taxes; failure to pay over employment taxes; penalty.

[2] If the employment tax withheld cannot be collected from the employer corporation, it may be collected in the form of a 100% penalty from the officer or officers of the corporation responsible for the failure to pay it over, since such individuals have the duty to carry out what the law requires of the corporation, namely, the segregation and payment over to the Government of trust funds withheld from employees' wages.

Internal Revenue ⚖2332

Taxes; employment taxes; failure to pay over employment taxes; penalty.

[3] As an employer withholds taxes from its employees' wages, a contingent liability is created, and the liability merely becomes fixed on the due date. The fact that the returns and final payment of the withheld taxes are not due until later is not relevant with respect to the penalty prescribed by Secs. 6672 and 7501 of the Code.

Internal Revenue ⚖1766.3, 2331

Taxes; employment taxes; failure to pay over employment taxes; willfulness.

[4] If the preference for the debts of other creditors over the liability to the United States by one under a duty to pay over payroll taxes is

Syllabus

intentional, it constitutes a willful failure to collect and pay over the taxes within the meaning of Sec. 6672 of the Code.

Internal Revenue ⚖2341

Taxes; employment taxes; failure to pay over employment taxes; responsible officer or person.

[5] Sec. 6672 of the Code does not confine liability for unpaid withheld payroll taxes only to the single officer with the greatest or the closest control or authority over corporate affairs. Realistically read, Sec. 6672(b) encompasses all those who are so connected with a corporation as to have the responsibility and authority to avoid the default which constitutes a violation of Sec. 6672, even though liability may thus be imposed on more than one person.

Internal Revenue ⚖2332

Taxes; employment taxes; failure to pay over employment taxes; liability for payment.

[6] Previous withdrawal by a corporate officer of sums theretofore advanced by him to the corporation, cannot mitigate the liability of other corporate officers having the responsibility for collecting and paying over to the Government withheld payroll taxes who used withheld funds to pay other creditors.

Internal Revenue ⚖2346

Taxes; employment taxes; failure to pay over employment taxes; responsible officer or person.

[7] A corporate officer may be liable for failure to pay over withheld payroll taxes even though his control over the disposition of corporate funds is limited by the requirement that his and another signature be on every check disbursing such funds.

Internal Revenue ⚖2364

Taxes; employment taxes; failure to pay over employment taxes; willfulness.

[8] In order to hold a person liable under Sec. 6672 of the Code, it is necessary not only that he be responsible for collecting and paying over to the Government withheld payroll taxes, but also that his failure to pay the taxes was willful. While more than mere negligence is required for "willfulness," willful conduct may include a reckless disregard for obvious or known risks.

Internal Revenue ⚖2341

Taxes; employment taxes; failure to pay over employment taxes; willfulness, burden of proof.

[9] The burden of proof respecting an allegation of absence of willfulness in a suit for refund of the 100% penalty assessment imposed on corporate officers because of their failure to pay over withheld payroll taxes, and on the counterclaim for assessed and unpaid penalty, is on the officers, requiring them to show that the Commissioner's determinations were erroneous.

Internal Revenue ⚖2368.1

Opinion of the Court

Taxes; employment taxes; failure to pay over employment taxes; responsible officer or person.

[10] Plaintiff, who as vice-president for finance, secretary and treasurer of the subject corporations, had authority to cosign checks thereby exercising a measure of control over disbursement of funds, was responsible for preparation of current corporate consolidated financial statements, chose which creditors to pay and dealt directly with some of them, and monitored and approved "request for check" forms for payment of corporate debts, was a responsible person required to collect, truthfully account for and pay over taxes within the purview of the statute.

Internal Revenue ⇨2332

Taxes; employment taxes; failure to pay over employment taxes; willfulness.

[11] Where a responsible corporate officer under a duty to pay over withheld payroll taxes to the Government intentionally did not set aside the withheld taxes as trust funds, he did not make deposits in trust accounts at Federal Reserve banks, but instead treated the trust funds as any other assets to be used for business purposes and chose to pay corporate creditors other than the United States, such actions constitute a willful failure to collect and pay over the taxes within the meaning of Sec. 6672 of the Code.

Internal Revenue ⇨2341

Alvin L. Freeman, attorney of record, for plaintiffs. *Freeman & Rockwell*, of counsel.

James L. Malone, III, with whom was *Assistant Attorney General M. Carr Ferguson*, for defendant. *Theodore D. Peyser* and *Donald H. Olson*, of counsel.

Before COWEN, *Senior Judge*, DAVIS and NICHOLS, *Judges*.

PER CURIAM: The cases pertaining to the plaintiff, Robert R. Bolding, Nos. 345–73 and 348–73, come before the court on plaintiff's exceptions to the recommended decision of Trial Judge Philip R. Miller, filed March 3, 1977, pursuant to Rule 134(h), having been submitted to the court on the briefs and oral argument of counsel.

The cases pertaining to the plaintiffs, Robert Dewey McMillan, Jr., Nos. 346–73, 349–73 and 351–73, and Milburn R. Vernor, No. 347–73, come before the court on plaintiffs' motion, filed September 7, 1977, requesting that as to them the court adopt, as the basis for its judgment in these cases, the said recommended decision of Trial Judge

Miller, defendant having filed no intention to except or exception thereto and the time for so filing pursuant to the Rules of the court having expired. As to these cases there has been no oral argument.

Upon consideration thereof, since the court agrees with the trial judge's decision, as hereinafter set forth*, it hereby affirms and adopts the said decision as the basis for its judgment in this case. Therefore, for the reasons set forth in the decision it is concluded that the plaintiff, Robert R. Bolding is not entitled to recover and that defendant is entitled to recover against him on its counterclaim with the amount of such recovery and ultimate dismissal of Bolding's petitions to be accomplished in further proceedings pursuant to Rule 131(c). Further, it is concluded that the plaintiffs, Robert Dewey McMillan, Jr., and Milburn R. Vernor are entitled to recover and judgment is entered for them with defendant not entitled to recover against them and defendant's counterclaims against them are dismissed. The amounts of these plaintiffs' recoveries will also be determined pursuant to Rule 131(c).

OPINION OF TRIAL JUDGE

MILLER, *Trial Judge:* The plaintiffs in the instant cases have brought this suit for the refund of token payments made by them after they had been assessed 100 percent penalties as corporate officers for their willful failure to pay over Federal Insurance Contributing Act (FICA) and income withholding taxes (hereinafter payroll taxes) on wages paid to the employees of three corporations.[1] The Government has counterclaimed for the balances of the assessments. At stake with respect to the plaintiff Bolding is $60,062.83, plaintiff McMillan, $66,421.84 and plaintiff Vernor, $17,124.26.

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* Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed March 3, 1977, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

[1] Bolding has paid $67.99 with respect to Gulf Aerospace Corporation, $4.94 with respect to Vernor Manufacturing Company, and $12.78 with respect to Circuit Products, Inc. The comparable amounts paid by McMillan are $67.99, $11.67 and $12.78. Vernor paid $7.28 with respect to Vernor Manufacturing alone.

Opinion of Trial Judge

INTERNAL REVENUE CODE, section 6672, provides that any person who as a corporate officer or employee has a duty to collect and pay over such payroll taxes withheld from the wages of employees shall be liable to a penalty equal to the amount of taxes in question, if he willfully fails to pay over such taxes to the Government. The questions to be resolved are whether each of the plaintiffs was a party responsible for collecting and paying over the withheld payroll taxes and whether his failure to do so was willful.

The payroll taxes in question are owed by three corporations, Gulf Aerospace Corporation (Gulf) and two of its subsidiaries, Circuit Products, Inc. (Circuit) and Vernor Manufacturing Company (Vernor Manufacturing). All three failed to pay over to the Government their withheld payroll taxes for the first two quarters of 1969, while Vernor Manufacturing also failed to pay over such taxes for the last two quarters of 1968. All three corporations became bankrupt April 23, 1969.

Plaintiff Robert R. Bolding is a certified public accountant, who initially started to work for Gulf as an independent consultant on financial and accounting matters in December 1968, and from January 29, 1969 until bankruptcy was vice president for finance, secretary and treasurer of all three companies and a member of the board of directors of Gulf. Plaintiff Robert D. McMillan, Jr., was senior vice president of Gulf, vice president of Circuit and Vernor Manufacturing and a member of the boards of directors of all three. Plaintiff Milburn R. Vernor was president of Vernor Manufacturing and a member of its board.

From May 1968 until the time of bankruptcy, Gulf, the parent corporation, did not comply with the requirement that withheld payroll taxes be deposited semimonthly as trust funds in special accounts at authorized Federal Reserve banks.[2] In June 1968, Donald Sumners, Gulf's

[2] During the years at issue, if the taxes with respect to wages for any calendar month during the preceding calendar quarter exceeded $2,500, an employer was required to deposit in an authorized Federal Reserve bank an estimated 90 percent of the taxes on the payroll paid during each semimonthly period within 3 banking days thereafter. The balance of the taxes due was to be paid within 3 banking days after the 15th day of the following month. Treas. Reg. § 31.6302(c)-1(a)(1), T.D. 6903, 1967-1 C.B. 347, adopted pursuant to the authority of I.R.C. § 6302(c) and 7501.

chief accountant, spoke to Emmett R. Collins, Gulf's controller, about the need to make such tax deposits. Collins replied that there was not enough money with which to do so. Sumners did not bring the delinquency to the attention of McMillan or Vernor, and he left Gulf in the latter part of 1968, before Bolding arrived.

Although Gulf failed to make timely payroll tax deposits, it did file timely quarterly returns for the last two quarters of 1968 and paid the taxes it owed for those quarters with the returns. The same was not true for its two subsidiaries, Circuit and Vernor Manufacturing. After Circuit had been acquired by Gulf in July of 1968, it ceased to make the required trust deposits. In addition, it had outstanding payroll tax liabilities at the time of acquisition. Shortly thereafter, Norman J. Wogan, Circuit's president, brought to the attention of Patrick H. Buvens, Gulf's president, the failure to make the necessary tax deposits. Buvens told him to file the returns for 1968 without paying the taxes and they would be taken care of later. They were not fully paid until late March 1969.

Vernor Manufacturing similarly did not pay its payroll tax liabilities for the last two quarters of 1968. After its acquisition by Gulf in mid-1968, it transferred many of its accounting operations to the parent company's accounting department. This failure to pay the taxes for the third quarter of 1968 may initially have arisen because of confusion in regard to whether Vernor Manufacturing or the Gulf accounting department was to handle the returns. However, when the returns were subsequently prepared in January 1969, the checks that had been made out to pay the taxes were never signed or issued.

From late 1968 until the date of bankruptcy, it was common knowledge among the employees of Gulf and its subsidiaries that the companies were in a difficult cash position. The economic problems at Gulf became worse prior to March of 1969. The cash position of the companies was so bad that shortly before the bankruptcy, Gulf and its

An employer was also required to file quarterly returns (Form 941) for FICA and income tax withholding taxes on or before the last day of the month following the quarter, or 10 days later if he had made timely semimonthly deposits. Treas. Reg. § 31.6011 (a)–1(a)(1) and 6011(a)–4 (1959); 31.6071(a)–1, T.D. 6941, 1968–1 C.B. 543, 546.

subsidiaries were on a cash-on-delivery or prepayment basis with most suppliers.

Buvens maintained very close financial control over Gulf and its subsidiaries. He and Collins supervised the payment of creditors. They followed daily reports on the cash position of the companies. When Buvens was present, checks, even when made out, were normally not released without his approval. Similarly, permission had to be obtained from Buvens by the heads of the operating divisions before even small items could be purchased.

McMillan, senior vice president of Gulf, was not in charge of financial affairs. His duties were concerned primarily with manufacturing and assembly operations of all three companies. However, he did participate in financial matters by assisting in the preparation of budgets and supporting the staffs of the various operating divisions in their efforts to obtain necessary supplies and equipment. They and McMillan set up priority lists which ranked creditors in accordance with their importance in keeping the operations going. They also made up requirements lists of supplies and equipment necessary for production. McMillan would confer with Buvens on the priority and requirements lists. Buvens normally, although not always, followed the priority lists of creditors given by the operating divisions.

The accounting records maintained by the Gulf accounting department were in poor condition. For several reasons there tended to be a material understatement of liabilities at any given time. First, the records were not kept up-to-date. Second, liabilities were not always recorded currently. Third, checks were sometimes made out by the accounting department regardless of whether funds were available and entered in the general ledger as reducing liabilities, despite the fact that Collins and Buvens still retained them because of insufficient funds.

As part of an effort to obtain additional working capital, Gulf had to issue an accurate financial report. Its certified public accountants, Touche, Ross, Bailey & Smart, began an audit of its records for the accounting period ending September 30, 1968. Shortly thereafter the firm informed Buvens that additional in-house work had to be performed

before it could certify any financial report. It recommended to Buvens for this purpose Bolding, an independent CPA, and Buvens retained him in early December 1968 to work as a consultant with the primary duty to assist the auditors by working on the accounts payable and inventory.

On January 29, 1969, Bolding was hired on a more permanent basis, as vice president for finance, secretary and treasurer of Gulf and its subsidiaries. He continued to be responsible for the accounting work for the audit for the period ending September 30, 1968; however, he also was involved with other more current financial matters. He reviewed or signed as the authorizing party numerous requests for the issuance of checks, thereby acquiring a measure of control over the disbursement of funds. He also had the responsibility to prepare current consolidated financial statements for Gulf and its subsidiaries, and he was charged with improving their accounting systems.

Bolding also concerned himself with the payment of creditors. The heads of the various operating divisions talked with him about their financial requirements and the necessity of paying first those suppliers whose products were needed most. Bolding would then convey this information to Buvens. In some instances he also dealt directly with creditors who were seeking collection of past-due or disputed accounts.

From late December 1968 until the time of bankruptcy the payroll tax forms for the parent company were prepared in Gulf's accounting department by Layton Hughens, the chief accountant. He reported directly to Collins, his immediate superior. He did not work with Bolding on the tax returns.

McMillan had been authorized to sign checks on the accounts of Gulf and its subsidiaries since April 1968. He, together with one cosignatory, could sign checks in amounts up to $5,000. It is not clear as to when Bolding received his initial check-signing authority. Bolding's first signed checks are dated January 29, 1969.

Before March 1969, McMillan and Bolding only signed checks occasionally. Buvens or Collins normally signed smaller checks for the payment of Gulf's creditors and they signed larger ones jointly. Until March 1969, McMillan and

Bolding would ordinarily sign checks only in situations in which Buvens and Collins were absent and there was no reason to await their return, such as when a C.O.D. delivery from a supplier arrived.

Bolding's authority over the financial affairs of Gulf increased with the passage of time. In late February 1969, a resolution, effective March 5, 1969, increased Bolding's and McMillan's authority to issue checks on their joint signatures on the main accounts of Gulf and Vernor Manufacturing from $5,000 to $25,000.

During much of the period from early March 1969 up to bankruptcy, Buvens was away from the company. He went on a 2-week vacation to South America; he traveled to Washington, D.C., for contract negotiations in which Gulf was involved. In addition, he was ill part of the time. Collins also was absent from his office during part of this period for both personal and business reasons. He too went to Washington for contract negotiations.

During this period, Bolding and McMillan jointly exercised their authority over disbursements and payment of creditors. Their check-signing activity increased markedly. Of the 228 Gulf checks drawn for payment of creditors during March and April 1969, Bolding's signature appears on 193 in the aggregate sum of $257,323, while McMillan's signature appears on 114 in the total amount of $173,767. For the same period, Bolding's signature appears on at least six Circuit checks for $8,707 in disbursements to creditors, while McMillan's is on five for $8,568; and Bolding's signature appears on $11,894 in Vernor Manufacturing checks, while McMillan's is on $9,920.

Milburn R. Vernor, the third plaintiff, was president of Vernor Manufacturing and responsible only for the fabrication and assembly operations thereof. After July of 1968 he was not a signatory on any Vernor Manufacturing checking account and, thus, had no part in the dissipation of the tax trust funds of any of the corporations. In its brief defendant concedes that Vernor may not be held liable for any of the penalties in issue.

Under the system of withholding taxes provided by the INTERNAL REVENUE CODE, employees are entitled to credit for the amounts of FICA and income taxes withheld from

their wages regardless of whether or not the employer turns the funds over to the Government. I.R.C. §§ 1462, 3102(a); *Dillard* v. *Patterson*, 326 F.2d 302, 304 (5th Cir. 1963). Since, therefore, the Government may actually be out-of-pocket by way of credit or refund for taxes it has never received, Congress has allowed the IRS more stringent protective devices to insure collection of payroll taxes than in the case of many other taxes. Liability for the payment over of withholding taxes arises at the time the sums are withheld from the employees' wages rather than at the later date when the employer's quarterly tax return is filed. *Kalb* v. *United States*, 505 F.2d 506, 509 (2d Cir. 1974), *cert. denied*, 421 U.S. 979 (1975). *Long* v. *Bacon*, 239 F.Supp. 911 (S.D. Iowa 1965); *Seaton* v. *United States*, 254 F.Supp. 161 (W.D. Mo. 1966). The amount of tax collected by the employer is held to be "a special fund in trust for the United States". I.R.C. § 7501(a). Ninety percent of such trust funds is required to be deposited in a special account in a Federal Reserve bank semimonthly and the remainder during the following month, even prior to the due date of the quarterly return. I.R.C. § 6302(c); Treas. Reg. 31.6302(c)–1(a), T.D. 6903, 1967–1 C.B. 347. If the withheld tax cannot be collected from the employer corporation it may be collected in the form of a 100-percent penalty from the officers responsible for the failure to pay it over. I.R.C. § 6672.[3]

Section 6672 provides:

> § 6672. Failure to collect and pay over tax, or attempt to evade or defeat tax
>
> Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof,

[3] The nature of the penalty as primarily a collection device is confirmed by IRS Policy Statement P–5–60, approved November 5, 1956 (IR Manual MT 1218–56, dated February 25, 1976, reproduced in 8 CCH 1977 Stand. Fed. Tax Rep. ¶ 5569), which provides that the penalty may be collected from the officer only if the tax cannot be collected from the corporation itself. And *see also McCarty* v. *United States*, 194 Ct. Cl. 42, 61–62, 68, 437 F.2d 961, 971, 975 (1971). Defendant also states in its answer that any judgment obtained in this case for the amount of the penalty sought in the counterclaim will be abated to the extent that it is collected from other officers who are also liable.

shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. * * *

Section 6671 makes it clear that the person referred to in section 6672 is meant to include the corporate employer's officer. It states:

§ 6671. Rules for application of assessable penalties

* * * *

(b) Person defined.—The term "person", as used in this subchapter, includes an officer or employee of a corporation, * * * who as such officer, employee, * * * is under a duty to perform the act in respect of which the violation occurs.

Since a corporation acts through its officers, absent evidence to the contrary, presumptively a person who occupies the offices of vice president, secretary and treasurer with authority to make disbursements has the duty to carry out what the law requires of the corporation, namely, the segregation and payment over to the Government of trust funds withheld from employees' wages. *Newsome* v. *United States*, 431 F.2d 742, 746 (5th Cir. 1970). As Bolding served as vice president for finance, secretary and treasurer of Gulf, Circuit and Vernor Manufacturing from the latter part of January 1969, and McMillan was also senior vice president of all three corporations from an even earlier date, and as they had joint authority to disburse corporate funds from its bank accounts, unless rebutted the fair inference is that they were such persons as are defined by section 6671(b).

Bolding has attempted to down-rate his authority by showing that despite his titles he did not have full control over the accounting department. Collins, as controller, supervised the day-to-day activities of that department and did not take lightly Bolding's new authority over it; he was uncooperative and interfered with the carrying out of Bolding's instructions. Nevertheless, the record shows, Bolding did have a considerable financial role. He monitored and approved "Request for Check" forms for payment of corporate debts. His increased status vis-a-vis Collins is shown by the fact that by early March 1969 Bolding

became entitled to cosign checks for up to $25,000, while Collins' check-signing authority remained limited to $5,000 and with respect to Vernor Manufacturing was wholly withdrawn. In Buvens' absence, Bolding and McMillan, rather than Collins, were the highest executives present at the corporate premises. This is shown by the extensive check-signing and disbursement activities in which they were engaged during March and April 1969.

Were Bolding and McMillan responsible for the corporations' failure to turn over the withheld funds to the Government? Again the answer must be in the affirmative.

In March and April 1969, Vernor Manufacturing had failed to pay over and was delinquent with respect to at least $12,855 in 1968 payroll taxes, and up to April 23, the date of bankruptcy, the three corporations owed an aggregate of at least $53,567 more in 1969 payroll taxes. They did not set aside the withheld taxes as trust funds, nor did they make deposits in trust accounts at Federal Reserve banks. Instead, the corporations treated the trust funds as any other assets to be used for business purposes. The fact that the returns and final payment of the taxes for the first and second quarters of 1969 were not due until April 30, and June 30, 1969, respectively, is not relevant with respect to the penalty. "As the employer withholds taxes from employees' wages a contingent liability is created. The liability merely becomes fixed on the due date." *Kalb* v. *United States, supra* at 509; and *see also Newsome* v. *United States, supra* at 745–46.

Although Gulf owed payroll taxes of $42,041.56 for the quarter ended March 31, 1969, plus an additional $806.60 for the period from April 1, to April 23, 1969, when Gulf became bankrupt, during March and April in the exercise of his joint check-signing authority Bolding chose to pay creditors other than the United States an aggregate of $257,323. Although for the first and second quarters of 1969 until April 23, 1969, Circuit owed $6,449.42 in payroll taxes, Bolding cosigned checks on Circuit's bank account in payment of debts owed other creditors in the sum of $8,708. Although for the quarters ending December 31, 1968 through March 31, 1969, Vernor Manufacturing owed payroll taxes of $10,763.31, during March and April

Bolding signed checks on Vernor Manufacturing bank accounts in payment of other creditors in the sum of $11,894. The corresponding disbursements for the same periods over McMillan's signature are, respectively, $173,767, $8,568 and $9,920. It must, therefore, be concluded that sufficient funds were available from which to pay over to the United States the payroll tax liability of all three corporations, but that Bolding and McMillan used the funds instead to pay other creditors.

If the preference for the debts of other creditors over the liability to the United States by one under a duty to pay over payroll taxes is intentional, it constitutes a willful failure to collect and pay over the taxes within the meaning of section 6672. *Linda Scott* v. *United States*, 173 Ct. Cl. 650, 656, 354 F.2d 292, 296 (1965); *White* v. *United States*, 178 Ct. Cl. 765, 779, 372 F.2d 513, 521 (1967); *Burack* v. *United States*, 198 Ct. Cl. 855, 870, 461 F.2d 1282, 1291 (1972).

Plaintiffs place emphasis on the controlling role of Buvens in the financial affairs of the corporations. However, this does not help them. Section 6672 does not confine liability for the unpaid taxes only to the single officer with the greatest or the closest control or authority over corporate affairs. "Realistically read, [§ 6671(b)] encompasses all those who are so connected with a corporation as to have the responsibility and authority to avoid the default which constitutes a violation of [§ 6672], even though liability may thus be imposed on more than one person." *Linda Scott* v. *United States*, *supra*, 173 Ct. Cl. at 657, 354 F.2d at 296. And *see also McCarty* v. *United States*, 194 Ct. Cl. 42, 54–55, 437 F.2d 961, 967 (1971), *White* v. *United States*, 178 Ct. Cl. at 771, 372 F.2d at 517, and *Monday* v. *United States*, 421 F.2d 1210, 1214 (7th Cir.), *cert. denied*, 400 U.S. 821 (1970). (Nevertheless, as noted, defendant does state in its pleadings that to the extent it receives payment from others it will abate the judgments it seeks here on the counterclaims.)

Plaintiffs also point to Buvens' withdrawal of $123,990 from Gulf as a reason for setting aside the assessments against the plaintiffs. However, such withdrawal, asserted by Buvens to be in payment of sums previously advanced

by him, cannot mitigate the liability of others. The withdrawal took place February 7, 1969. As the record of Bolding's and McMillan's disbursements indicates, even after Buvens' withdrawal, from the beginning of March until the bankruptcy on April 23 they still had control over enough funds to pay over the tax liabilities of all three corporations, but opted in favor of other creditors.

The fact that neither Bolding nor McMillan was able to authorize the disbursements on his individual signature alone does not relieve them of liability. By withholding his signature each could have prevented the dissipation of the corporate funds which should have been set aside to pay the payroll taxes. In *Burack* v. *United States, supra,* 198 Ct. Cl. at 869, 461 F.2d at 1291, the court held that a corporate officer may be liable under section 6672 of the INTERNAL REVENUE CODE even though his control over the disposition of the corporate funds is limited by the requirement that there be two signatures on every check. The court stated:

> But to be a responsible person or officer under the statute, one does not have to be the sole such person or have "exclusive control over all corporate affairs * * *." The fact that the Raddings may also have qualified as responsible officers does not acquit plaintiff. The Raddings may have given directions as to what checks should be drawn to pay which creditors, but *those checks were worthless without plaintiff's cosignature. Authority to cosign in effect gives one the authority to decide which creditors should be paid.* Plaintiff may not have participated in the preparation of the checks, but he had the power to prevent disbursement of funds except to appropriate creditors, and there can be no question that he had as much power and authority as the Raddings to direct to whom checks should be drawn. [Emphasis added; citation omitted.]

And *see also McCarty* v. *United States, supra,* 194 Ct. Cl. at 56, 437 F.2d at 968; *Turner* v. *United States,* 423 F.2d 448 (9th Cir. 1970); *Silberberg* v. *United States,* 355 F.Supp. 1163, 1166–67 (S.D. N.Y. 1973); *Melillo* v. *United States,* 244 F.Supp. 323 (E.D. N.Y. 1965).

In order to hold a person liable under INTERNAL REVENUE CODE, section 6672, it is necessary not only that he be "responsible" but also that his failure to pay the

taxes be "willful." *Burack* v. *United States, supra,* 198 Ct. Cl. at 859, 461 F.2d at 1285.

The failure to pay over the taxes owed to the Government is deemed "willful" for the purposes of the statute if it results from (*White* v. *United States, supra,* 178 Ct. Cl. at 778–79, 372 F.2d at 521)—

> a deliberate choice voluntarily, consciously and intentionally made to pay other creditors instead of paying the Government, and * * * it is not necessary that there be present an intent to defraud or to deprive the United States of the taxes due, nor need bad motives or wicked design be proved in order to constitute willfulness.

Or as the Fifth Circuit put it in a practical context (*Newsome* v. *United States, supra* at 746):

> The responsible officer's actions before the due date for payment of the withheld taxes satisfies the "willfulness" requirement under section 6672: when the responsible officer (as defined by section 6671(b)) knows that the withheld funds are being used for other corporate purposes, regardless of his expectation that sufficient funds will be on hand on the due date for payment over to the government. Of course, the officer is only liable under section 6672 if the corporation does not pay over the withheld taxes at the date prescribed in the regulations. However, he subjects himself to liability under 6672 when he voluntarily and consciously "risks" the withheld taxes in the operation of the corporation, and subsequently the corporation is unable to remit the withheld taxes.

More than mere negligence is required for "willfulness"; a person is not "willful" if as a result of negligence he is unaware of the default in the payment of payroll taxes. *Bauer* v. *United States,* 211 Ct. Cl. 276, 289, 543 F.2d 142, 150 (1976). But willful conduct may also include "a reckless disregard for obvious or known risks." *Monday* v. *United States, supra* at 1215; *Kalb* v. *United States, supra* at 511.

Both Bolding and McMillan allege an absence of willfulness because they lacked knowledge as to the nonpayment of the taxes. The burden of proof on this issue, as on other elements of plaintiffs' claims and the Government's counterclaims for the unpaid balance of the assessments, was upon plaintiffs, requiring them to show that the Commis-

sioner's determinations were erroneous. *Liddon* v. *United States*, 448 F.2d 509, 513–14 (5th Cir. 1971), *cert. denied*, 406 U.S. 918 (1972); *Psaty* v. *United States*, 442 F.2d 1154, 1159–60 (3rd Cir. 1971); *Lesser* v. *United States*, 368 F.2d 306, 310 (2d Cir. 1966) (en banc); *Fitzgerald* v. *United States*, 407 F.Supp. 1132 (E.D. Ky. 1976).

The record fails to support Bolding's claim that he lacked knowledge of the unpaid payroll taxes.

Bolding is and was a certified public accountant. He was brought into the corporations in December 1968 to straighten out and simplify their accounting and to help prepare responsible and accurate financial statements which might enable the corporations to obtain additional financing. He apparently took hold of financial affairs rapidly, so that in 1 month he was appointed vice president for finance, and secretary and treasurer of all three corporations. In such offices he was to be in charge of accounting operations, accounts receivable, accounts payable, cost accounting and other matters relating to the preparation of the consolidated company financial reports. Department heads and the president of the subsidiaries discussed their financial needs with Bolding, and he made recommendations to Buvens as to meeting their requirements. He reviewed and sought to simplify the accounting systems and entries. He also engaged in the preparation of operating budgets for the 1969 year.

In view of the shortage of funds, Bolding participated in the establishment of priorities for payment of suppliers and other creditors. He dealt directly with creditors with respect to the accuracy of their billings and the corporations' past-due accounts. He sought to obtain better control over disbursements by reviewing and subjecting requests for the issuance of checks to his prior approval. And most importantly, as previously noted, he was delegated authority to sign and countersign checks for up to $25,000 in payment of creditors, an authority which he exercised in many instances in Buvens' absence.

In a position of such responsibility Bolding could hardly have functioned without an overall view of the accounting records and financial conditions of the three corporations.

J. Layton Hughens, Gulf's chief accountant, testified without contradiction that each month he entered the payroll taxes withheld from wages paid during the month in separate accounts in the accounts payable ledger, and no later than the 15th or 20th of the following month he prepared and turned over to Bolding a monthly financial statement. Bolding also received and reviewed monthly trial balances from the subsidiaries. Intercorporate memoranda show that he directed they be furnished him by about 1 week after the close of the month. These would necessarily show the balances in the payroll tax liability accounts. At the same time Bolding received daily cash statements showing receipts and disbursements by items, and, therefore, unquestionably the knowledge was available to him that no checks for the payroll taxes had been issued.

In late January 1969, Bolding prepared the payroll tax returns of Vernor Manufacturing for the third and fourth quarters of 1968, at least the first of which was necessarily delinquent (since it should have been filed by October 31, 1968.) Treas. Reg. § 31.6071(a)–1, T.D. 6941, 1968–1 C.B. 543, 546. Checks were prepared for payment of the taxes, but they were not signed, and at some unspecified later time they were marked "void". Although Bolding maintains he was unaware that the checks were not paid, they were never entered as payments in the ledger accounts showing the tax liabilities and hence the unpaid taxes continued to be shown on the Vernor Manufacturing trial balances for January, February and March 1969, which Bolding received and reviewed. Moreover, the checks never appeared as disbursements in the daily cash statements furnished Bolding.

Norman J. Wogan, the president of Circuit, testified that he told Bolding about Circuit's outstanding payroll tax liabilities. Moreover, Circuit's books were not subject to criticism that the accounting therein was sloppy and incomplete, as in the case of Gulf. Circuit had its own bookkeeper and maintained its own records. Payrolls and payroll tax returns were prepared by Circuit's bookkeeper. The accounts were kept current and accrued tax liabilities

for the tax trust funds not deposited were recorded in them.

Even apart from the trial balances, financial statements and Bolding's general familiarity with the financial affairs of the corporations, other evidence supports the inference that Bolding knew of the accrued payroll tax liabilities. He unquestionably knew that the corporations had large payrolls and that they deducted and withheld payroll taxes from the employees. As previously discussed, the corporations' liability for the payroll taxes arose at the time of the withholding. The only way the corporations could have acquitted themselves of their liability prior to the filing of their quarterly returns was by making the semimonthly deposits in trust in a Federal Reserve bank, as set forth in the Treasury Regulations. From the beginning of the year to April 23, 1969, the date of bankruptcy, seven such deposits were due. Only Circuit made one, on April 7, 1969, in the sum of $1,865.19. From the daily cash statements and the record of disbursements, plus the fact that he personally was not called upon to sign or countersign checks for payroll tax deposits during the period when Buvens was away and he and McMillan were in charge of finances, Bolding must have necessarily been aware that the companies were failing to make the deposits and that the payroll taxes remained due.

Under all of the circumstances of Bolding's participation in and supervision of the financial affairs of the three companies, his argument that he paid attention only to the commercial accounts payable and was unaware of accounts showing more than $48,000 in unpaid Gulf payroll taxes and $66,000 for all three companies strains credulity. At best, his argument amounts to the position that even with knowledge of a corporation's financial straits a responsible officer may immunize himself from the consequences of his actions by wearing blinders which will shut out all knowledge of the liability for and the nonpayment of its withholding taxes. But such a deliberate or reckless disregard of the facts and known risks cannot blunt the impact of the penalty statute on those responsible for such nonpayment. *United States* v. *Leuschner*, 336 F.2d 246 (9th

Conclusion of Law

Cir. 1964); *Monday* v. *United States, supra; Fitzgerald* v. *United States, supra* at 1136.

Although McMillan was a responsible person, the record is insufficient to refute his testimony that he was unaware of the failure to pay the taxes or make the required deposits. Although he signed numerous checks as a cosignatory, he was not responsible for accounting or for supervising finances. His specialization was the manufacturing and assembly end of the business. In light of his duties and responsibilities there is no basis for imputing to him either knowledge or reckless disregard of the unpaid payroll tax liabilities, or of the failure to make the trust deposits. Therefore, he is not liable for the willful failure to pay over the taxes under section 6672.

CONCLUSIONS OF LAW

I

Bolding was a responsible person within the meaning of I.R.C. § 6671(b), who was required to collect, truthfully account for, and pay over the payroll taxes due from Gulf, Circuit and Vernor Manufacturing. He willfully failed to do so and he is therefore liable for the penalties assessed against him pursuant to I.R.C. § 6672. Bolding is accordingly not entitled to a refund of the portion of the penalties paid and is liable to defendant for the amount assessed and unpaid. He is not entitled to recover; and defendant is entitled to recover against him on its counterclaim. The amount of the recovery is to be determined pursuant to Rule 131(c).

II

McMillan, although a responsible person, did not act willfully in regard to the failure of Gulf and its subsidiaries to pay the payroll taxes. Therefore, he is not liable and is entitled to recover the amount he paid; while defendant is not entitled to recover on its counterclaim and it is dismissed. The amount of the recovery is to be determined pursuant to Rule 131(c).

Syllabus

III

Vernor was not a responsible person in regard to the failure of Vernor Manufacturing to pay the payroll taxes. Therefore, he is not liable and is entitled to recover the amount he paid; while defendant's counterclaim is dismissed. The amount of the recovery is to be determined pursuant to Rule 131(c).

CHARLES BOWSER, ET AL. v. THE UNITED STATES

[No. 176–75. Decided December 14, 1977]

ON DEFENDANT'S AND PLAINTIFFS' MOTIONS FOR SUMMARY JUDGMENT

Civilian pay; overtime pay; standby time; immigration inspectors.—Plaintiffs, present or former employees of the Immigration and Naturalization Service, seek compensation for overtime and standby time under 5 U.S.C. §§ 5542 and 5545 in addition to overtime already paid to each of them under 8 U.S.C. § 1353a, for the period May 23, 1969 to February 15, 1974. Under new Government inspection procedures adopted May 12, 1965, plaintiffs, in addition to their usual tasks, were required to conduct customs inspections for all commercial vessels and yachts entering the United States between 5:00 p.m. and 8:00 a.m. and on weekends and holidays, on a rotating overtime basis. Each plaintiff was also required in rotation to remain near his home telephone awaiting orders to conduct such inspections, called standby duty, amounting to at least 25% of each year. The court accepts plaintiffs' assertion that these duties were not assigned on a voluntary basis. In view of the express terms of 5 U.S.C. § 5545 and precedents consistently holding that standby duty performed at an employee's residence is not compensable, it is *held* that plaintiffs are not entitled to recover any premium pay based on standby duty. It is also *held* that plaintiffs are not entitled to additional overtime pay for dual inspections, which they performed but allegedly were not fully compensated for, because of their failure to substantiate the claim of nonpayment. Plaintiffs' request for a trial is denied. Defendant's motion for summary judgment is granted, plaintiffs' cross-motion is denied and the petition is dismissed.

Civilian pay; overtime pay; immigration inspectors.

[1] In light of 5 U.S.C. § 5549 prohibiting concurrent premium pay, to the extent that the pay for phantom hours of 8 U.S.C. § 1353a is

construed to compensate immigration inspectors both for standby time at home awaiting calls when needed as well as for actual inspections performed at irregular hours, § 5549 bars any additional payment for standby time under 5 U.S.C. 5545.

Aliens ⚖43

Civilian pay; overtime pay; standby time; immigration inspectors.

[2] Assuming, *arguendo*, that the pay for phantom hours of 8 U.S.C. § 1353a does not compensate immigration inspectors for the standby time spent at home in readiness to make an immediate departure for the port to inspect an arriving vessel, 5 U.S.C. § 5545 bars such employees from recovering for the standby status. Standby time is not compensable unless performed at the employee's office or duty station.

Aliens ⚖43

Pleading and practice; summary judgment; affidavits supporting motion.

[3] Rule 101(f) requires that affidavits supporting a motion for summary judgment be made on personal knowledge. Absent an affidavit in compliance with the Rule to substantiate plaintiffs' claims that they were not fully paid for all inspections performed during the period in issue, a trial to determine their entitlement to additional compensation is inappropriate over an opposing motion for summary judgment.

Federal Courts ⚖1120

Joseph P. Marro, attorney of record for plaintiff.

Lawrence S. Smith, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before COWEN, *Senior Judge*, DAVIS and NICHOLS, *Judges*.

NICHOLS, *Judge*, delivered the opinion of the court:

Plaintiffs in this civilian pay case are ten immigration inspectors, presently or formerly employed by the Immigration and Naturalization Service, claiming compensation for overtime and standby time in addition to overtime already paid to each of them, for the period from May 23, 1969 until February 15, 1974. Throughout this period plaintiffs were assigned to the Immigration suboffices at Port Everglades and West Palm Beach, Florida. Prior to May 12, 1965, their duties consisted primarily of conducting inspections of aliens seeking admission to the United States at these ports of entry.

On May 12, 1965, the Immigration and Naturalization Service and the United States Bureau of Customs adopted

a joint inspections procedure modifying plaintiffs' duties. The object was to conserve person power (we presume manpower is a taboo word) by mutual assumption of one another's inspectional duties. In addition to their usual tasks as immigrations inspectors, under the new procedure plaintiffs were also required to conduct customs inspections for all commercial vessels and yachts entering the United States between 5:00 p.m. and 8:00 a.m., and on weekends and holidays. It is stated that private yachts, particularly, were —ften —uilty of arriving with short advance radio notification or none at all. Inspectors were scheduled to perform these dual inspections on a rotating basis. In conjunction with overtime inspections, they were also required to serve standby duty at their homes prepared to receive telephone notice of a need for their services, and to depart, at once or nearly, to the port of entry for the purpose of inspecting arriving vessels and aliens. Only four individuals were available for this duty at each port, and, consequently, each plaintiff was on standby duty at least 25 percent of each year. Plaintiffs state that standby duty was obligatory and interfered substantially with their family and social lives. Without disputing about semantics, —e call this duty of awaiting telephone calls standby duty because plaintiffs do. In view of the result we reach, we state the facts according to plaintiffs' version.

Defendant has offered evidence to the effect that because of the lucrative nature of the overtime income, inspectors were far from reluctant to be available for overtime inspections. A Deputy District Director for the Immigration and Naturalization Service stated that in many ports the inspection officers were free to work out overtime arrangements among themselves, and were not subject to a directive that particular individuals be available at specific times. Plaintiffs assert, and we assume, that the scheduling and posting of names and hours for awaiting calls was a function performed by management.

Although there is some controversy as to whether standby and overtime duties were truly mandatory, we will accept plaintiffs' assertion that these duties were not assigned on a voluntary basis. Even so, under existing law,

we cannot order further premium compensation for plaintiffs.

Plaintiffs have been amply compensated for their overtime duty under the terms of 8 U.S.C. § 1353a, which pertains specifically to employees of the Immigration and Naturalization Service, and provides, in pertinent part:

> The Attorney General shall fix a reasonable rate of extra compensation for overtime services of immigration officers and employees of the Immigration and Naturalization Service who may be required to remain on duty between the hours of five o'clock postmeridian and eight o'clock antemeridian, or on Sundays or holidays, to perform duties in connection with the examination and landing of passengers and crews of steamships, trains, airplanes or other vehicles, arriving in the United States from a foreign port by water, land, or air, such rates to be fixed on a basis of one-half day's additional pay for each two hours or fraction thereof of at least one hour that the overtime extends beyond five o'clock postmeridian (but not to exceed two and one-half days' pay for the full period from five o'clock postmeridian to eight o'clock antemeridian) and two additional days' pay for Sunday and holiday duty; * * *.

By guaranteeing that inspectors will be paid at least double their normal hourly wage for inspections performed outside of office hours, section 1353a effects a generous system of phantom hours for those employees called upon to conduct inspections at irregular, and perhaps inconvenient, times. An employee who works, for example, two hours or any fraction thereof during the designated hours, is paid for a half-day; if he works three hours, or up to four hours, he is paid for a full days' work. In other words, for every two hours he works, he is paid for another two hours which in reality he did not work. Hence, the term "phantom" hours. To illustrate the level of compensation of plaintiffs pursuant to section 1353a, overtime and total pay for the year 1973 was as follows:

	Regular Salary	*Overtime Salary*	*Total*
Bowser	$15,155.20	$17,139.57	$32,294.77
Carter	15,504.80	17,577.03	33,081.83
Cockerel	11,666.40	17,279.61	28,946.01
Grimm	14,553.60	16,206.56	30,505.54
Harvin	13,798.80	21,445.45	34,658.25
Kile	10,164.48	13,798.91	23,963.39
McHugh	18,265.60	23,013.14	41,278.74
Ryals	15,097.60	22,788.98	37,886.58
Smith	14,382.40	17,259.41	31,641.81
Turner	15,155.20	17,564.41	32,719.61

Presumably, this liberal feature is intended in some measure to recompense for the disruption of the home lives of officers who must be available for and report to duty at unusual hours. At least, such disruption is commonly urged as justifying it. The question presented to this court is whether plaintiffs, who have already been paid under section 1353a for hours at the duty station, can recover any further amounts under other statutes pertaining to government employees.

The general provisions governing premium pay for federal employees are contained in subchapter V of 5 U.S.C. §§ 5541–49. Section 5542 sets forth the overall scheme for overtime pay by providing that work in excess of the basic 40 hour workweek shall be compensated at an hourly rate equal to one and one-half times the hourly rate of basic pay of the employee. Section 5545 establishes a pay differential for night, standby, Sunday, irregular, and hazardous duty. Section 5549 precludes any employee from obtaining overtime, or premium, pay, under subchapter V for services for which he has already been compensated under 8 U.S.C. § 1353a. Insofar as relevant, the texts of these provisions are contained in the Appendix following this opinion.

Plaintiffs fix their sights primarily on the § 5545 differential for standby and irregular time. When this is made applicable, no attempt is made to record or calculate the actual hours worked and instead an addition is made to

the basic annual salary at an arbitrary rate, not in excess of 25 percent. They say that management abused its discretion in not fixing such a rate for them. They focus less on the time and a half rate under § 5542(a). What we say hereinafter will apply to both so far as the context permits. We may assume that on any day, besides the alleged standby, they will have performed at least eight regularly scheduled hours at the office or duty station.

In light of the prohibition against concurrent premium pay, to the extent that the phantom hours feature of section 1353a is construed to compensate plaintiffs both for being expected to be available at their homes when needed as well as for actual inspections performed at irregular hours, section 5549 would clearly bar any additional payment for standby time under section 5545.

The court need not base its decision concerning the claim for standby time on these grounds, however. Even assuming, *arguendo*, that section 1353a's phantom pay does not compensate plaintiffs for the time they are required to expend remaining at home in readiness to make an immediate departure for the port to inspect an arriving vessel, it still does not follow that plaintiffs are entitled to a pay differential under section 5545. The principle that federal employees cannot receive extra compensation for standby time of this nature is firmly established. *See, e.g., Aldridge* v. *United States*, 202 Ct. Cl. 365, 479 F.2d 1365 (1973); *Moss* v. *United States*, 173 Ct. Cl. 1169, 353 F.2d 746 (1965).

In *Moss* v. *United States*, *supra*, this court held that an attorney for the Immigration and Naturalization Service, who on occasion was ordered to perform telephone standby duty at home after regular daytime working hours and on weekends, could not recover overtime compensation for that standby duty. Except for being required to remain within hearing distance of the telephone, plaintiff was otherwise free to enjoy his normal pursuits. 173 Ct. Cl. at 1172, 353 F.2d at 747. Consequently, the court reasoned that the standby duty, which unarguably restricted Moss' activities to a degree, nevertheless did not amount to compensable hours of work. Although plaintiffs attempt to distinguish *Moss* on the ground that the claimant therein

was not expected to do anything other than receive telephone calls, while plaintiffs, once called were required to leave their homes and report for duty, this distinction ignores the overriding fact that the standby time was accumulated at plaintiffs' residences, rather than in their offices. It is now settled that standby time is not compensable unless performed at the claimant's office or station. *See Aldridge* v. *United States, supra; Detling* v. *United States*, 193 Ct. Cl. 125, 432 F.2d 462 (1970); *Moss* v. *United States, supra; Rapp* v. *United States*, 167 Ct. Cl. 852, 340 F.2d 635 (1964). Moreover, even standby time which is spent exclusively at the place of employment is not entirely compensable. Generally, even when the employee remains on government premises, any time set aside for sleeping or eating, during which the employee in fact does not perform any substantial labor, is excluded from the computation for compensable hours. *See Rapp* v. *United States, supra*, 167 Ct. Cl. at 866, 340 F.2d at 642–43. Thus, plaintiffs are barred from recovering for standby status under section 5545.

Although plaintiffs argue that an unreported case decided by a district court in Ohio, *Rothgeb* v. *Statts*, Civil Action No. 4082 (S.D. Ohio, Feb. 23, 1973), supports their contentions and should be regarded as controlling, this case in fact seems to follow settled law in regard to the compensability of standby time. In *Rothgeb*, plaintiffs were federal employees assigned to international air flights as sky marshalls, to protect passengers and crews from skyjackings. In this capacity, plaintiffs were required to remain at a motel located near the airport, essentially in standby status. The hotel accommodations were obtained by and paid for by the government. For purposes of evaluating compensability of standby duty, it appears that the motel rooms could reasonably be regarded as the employer's premises, or, in effect, the sky marshall's offices. This case, thus, is factually distinct from the instant matter, where plaintiffs waited in their own residences to be called to duty. *Rothgeb* simply does not support awarding compensation for standby time to plaintiffs.

Finally, it should be noted that the statutory provision relied upon by plaintiffs does not apply to them by its own terms. *See* text of section 5545, set forth in the Appendix following this opinion. Plaintiffs have not shown that the head of the Immigration and Naturalization Service has authorized any premium pay pursuant to section 5545. This cannot be argued to be abuse of discretion because the statute does not apply to plaintiffs. Section 5545 limits compensable standby status to those times when an employee remains "at, or within the confines of, his station." This, then, creates an inference that standby duty performed at an employee's residence is not intended to be compensable under section 5545. It might also be noted that in interpreting this premium pay provision in *Rapp* v. *United States, supra,* this court concluded that the provision was primarily aimed at the situation of firefighters, whose basic workweek and overtime was composed principally of standing by to respond to any emergencies which might arise.

In view of the express terms of section 5545, and precedent consistently holding that standby duty performed at an employee's residence is not to be compensated, we cannot find that these plaintiffs are entitled to recover any premium pay based on standby duty. Furthermore, there is no basis for granting a trial on any disputed facts, because the most material fact, *i.e.,* where the standby duty was performed, is agreed upon by the parties.

In addition to their claim for standby pay, plaintiffs seek additional overtime pay for dual inspections which they performed but allege they were not fully compensated for. More specifically, plaintiffs state that there were a number of instances when they performed inspections for which they were paid only a flat rate of $25.00, rather than the amount required by 8 U.S.C. § 1353a. Plaintiffs request an accounting, and a trial to determine whether they are entitled to additional compensation, and if so, to how much.

Other than an affidavit of a union officer representing immigration employees, there is no evidence before us to substantiate the claims that plaintiffs have not been fully paid for all inspections performed in the period for which suit is brought. This affidavit, as defendant points out, is

subject to a number of infirmities, but its principal deficiency is that it is not based on the personal knowledge of the affiant, who is not a plaintiff, and who does not, and has not ever performed dual inspections. *See* Rule 101(f), of the Rules of the Court of Claims. Plaintiffs have not supplied us with any affidavits or statements of their own, nor have they submitted any payroll data in support of their contentions. Plaintiffs nevertheless argue that there is a genuine issue, and that a trial is required so that discovery may proceed. It might be noted, however, that although the government states discovery was available to plaintiffs all along, no attempt has been made since the date of filing, two years ago, to seek discovery, nor has this failure to request discovery been explained.

Finally, these claims were submitted administratively, and, "after a diligent search of the records" denied because nothing was found to substantiate the claims. *Bowser* v. *United States,* Administrative Claim to the Immigration and Naturalization Service, letter of George Taempalez, Acting Associate Regional Commissioner, April 16, 1976. In the absence of a showing that the administrative determination is incorrect, or subject to challenge as, for example, being against the substantial weight of the evidence, such a finding should be upheld. *See, e.g., Wilmot* v. *United States,* 205 Ct. Cl. 666, 682 (1974); *Grover* v. *United States,* 200 Ct. Cl. 337, 353–54 (1973); *Morelli* v. *United States,* 177 Ct. Cl. 848, 858 (1966).

In short, in the absence of any supporting documentation for their assertions concerning the inadequacy of compensation for actual inspections, plaintiffs' request for a trial cannot be granted over an opposing motion for summary judgment.

Accordingly, defendant's motion for summary judgment is granted, plaintiffs' cross-motion for summary judgment is denied, and plaintiffs' petition is dismissed.

APPENDIX

5 U.S.C. § 5542 (1970), *as amended,* (Supp. V, 1975), provides in pertinent part:

§ 5542. Overtime rates; computation.

Appendix

(a) For full-time, part-time and intermittent tours of duty, hours of work officially ordered or approved in excess of 40 hours in an administrative workweek, or * * * in excess of 8 hours in a day, performed by an employee are overtime work and shall be paid for, * * * at the following rates:

(1) For an employee whose basic pay is at a rate which does not exceed the minimum rate of basic pay for GS–10, the overtime hourly rate of pay is an amount equal to one and one-half times the hourly rate of basic pay of the employee, and all that amount is premium pay.

(2) For an employee whose basic pay is at a rate which exceeds the minimum rate of basic pay for GS–10, the overtime hourly rate of pay is an amount equal to one and one-half times the hourly rate of the minimum rate of basic pay for GS–10, and all that amount is premium pay.

* * * * *

5 U.S.C. § 5545 (1970), *as amended*, (Supp. V, 1975), provides in pertinent part:

§ 5545. Night, standby, irregular, and hazarous duty differential.

(a) * * * [N]ightwork is regularly scheduled work between the hours of 6:00 p.m. and 6:00 a.m., * * *—

* * * * *

Except as otherwise provided by subsection (c) of this section, an employee is entitled to pay for nightwork at his rate of basic pay plus premium pay amounting to 10 percent of that basic rate. * * *

* * * * *

(c) The head of an agency, with the approval of the Civil Service Commission, may provide that—

(1) an employee in a position requiring him regularly to remain at, or within the confines of, his station during longer than ordinary periods of duty, a substantial part of which consists of remaining in a standby status rather than performing work, shall receive premium pay for this duty on an annual basis instead of premium pay provided by other provisions of this subchapter, except for irregular, unscheduled overtime duty in excess of his regularly scheduled weekly tour. Premium pay under this paragraph is determined as

an appropriate percentage, not in excess of 25 percent, of such part of the rate of basic pay for the position as does not exceed the minimum rate of basic pay for GS–10 * * *, by taking into consideration the number of hours of actual work required in the position, the number of hours required in a standby status at or within the confines of the station, the extent to which the duties of the position are made more onerous by night, Sunday, or holiday work, or by being extended over periods of more than 40 hours a week, and other relevant factors; or

(2) an employee in a position in which the hours of duty cannot be controlled administratively, and which requires substantial amounts of irregular, unscheduled, overtime duty with the employee generally being responsible for recognizing, without supervision, circumstances which require him to remain on duty, shall receive premium pay for this duty on an annual basis instead of premium pay provided by other provisions of this subchapter, except for regularly scheduled overtime, night, and Sunday duty, and for holiday duty. Premium pay under this paragraph is determined as an appropriate percentage, not less than 10 per centum nor more than 25 per centum, of such part of the rate of basic pay for the position as does not exceed the minimum rate of basic pay for GS–10, by taking into consideration the frequency and duration of irregular unscheduled overtime duty required in the position.

* * * * *

5 U.S.C. § 5549 (1970), provides in pertinent part:

§ 5549. Effect on other statutes.

This subchapter does not prevent payment for overtime services or for Sunday or holiday work under any of the following statutes—

* * * * *

(2) sections 1353a and 1353b of title 8;

* * * * *

However, an employee may not receive premium pay under this subchapter for the same services for which he is paid under one of these statutes.

Syllabus

567 F.2d 373

W. L. SCHAUTZ COMPANY v. THE UNITED STATES

[No. 227-75. Decided December 14, 1977]

OPINION

Taxes; income tax; deductions; loss on sale of vacation residence; use by taxpayer's shareholders.—This case is before the court on a stipulation of facts. In 1958 plaintiff, a family-owned corporation engaged in the business of yarn brokerage and yarn processing, purchased a vacation home in Florida for the personal use of its shareholders. Plaintiff did not hold the property for use in its trade or business. The property was sold in 1965 at a loss. The Internal Revenue Service disallowed the claimed loss deduction, plaintiff paid the deficiency assessment, and upon disallowance of its claims for refund plaintiff brought suit in this court seeking a refund for taxable year February 1, 1965 through January 31, 1966. It is *held* that Sec. 274(a) disallows the deductions by plaintiff of the loss incurred in the sale of the property. *International Trading Co.* v. *Commissioner*, 484 F. 2d 707 (7th Cir. 1973), *distinguished*. The petition is dismissed.

Taxes; income tax; taxable income; disallowance of deductions; entertainment, amusement or recreation.

[1] A winter vacation home is a facility used in connection with an activity generally considered to constitute recreation, entertainment or similar activity described under the terms of Sec. 274(a)(1) of the Code.

Internal Revenue ⚖555

Taxes; income tax; deductions; entertainment, amusement or recreation.

[2] Sec. 274(a) of the Code applies to deductions for losses incurred in the sale of, as well as expenses for maintenance, preservation or protection of, an entertainment, amusement or recreation facility.

Internal Revenue ⚖641

Taxes; income tax; deductions; losses; recreation facility, sale of.

[3] A corporate taxpayer is barred under Sec. 274(a)(1) of the Code from deducting a loss incurred in the sale of a winter vacation residence where the property was not used in taxpayer's trade or business but was used solely by taxpayer's shareholders. This is so despite the exception stated in Sec. 274(f) for a corporate taxpayer is treated as an individual taxpayer for purposes of applying the exception.

Internal Revenue ⚖641

Taxes; income tax; deductions; generally.

[4] While Sec. 1211(a) of the Code allows a corporate taxpayer to deduct capital losses to the extent there are capital gains, before any loss can be so offset it must be deductible under Sec. 165(a).

Internal Revenue ⚖608

Donald LaBarre, Jr. for plaintiff; *Robert Margolis,* attorney of record. *Margolis, LaBarre & Kucy,* of counsel.

Patricia B. Tucker, with whom was *Assistant Attorney General M. Carr Ferguson,* for defendant. *Theodore D. Peyser,* of counsel.

Before DAVIS and KASHIWA, *Judges.**

KASHIWA, *Judge,* delivered the opinion of the court:

This case is before us on an agreed stipulation of facts. The sole issue before the court for decision is whether a corporation is entitled to deduct a loss incurred from the sale in 1965 of a winter vacation home used solely by its shareholders. After careful consideration of the briefs and oral arguments presented, we hold it cannot for reasons hereafter stated.

The plaintiff, W. L. Schautz Company, is a corporation duly organized and existing under the laws of the Commonwealth of Pennsylvania, with its office located at 150 East Grove Street, Dunmore, Pennsylvania. Its business is yarn brokerage and yarn processing. During the period in issue, taxpayer was wholly owned by Walter L. Schautz, Sr., and members of his family.

In 1958, plaintiff purchased from an unrelated party a two-story, four-bedroom house located in a residential neighborhood of Palm Beach, Florida, about one block from the water. Plaintiff did not hold the property for use in its trade or business in any way. The property was held for the personal use of Walter L. Schautz, Sr., and his family, who used it as a winter vacation home.

From the time of the purchase in March 1958 until Mr. Schautz, Sr.'s death on January 1, 1961, the Schautz family used the property each year from the middle of October to the middle of April as a personal residence. After the death of Mr. Schautz, Sr., the property was vacant except for occasional use by his family. In some years the family paid rent for the use of the property. In fiscal 1959, no rent was paid. In fiscal 1960 and 1961, $3,600 in rent per year was

* Senior Judge Durfee sat for oral argument before his death. He took no part in the decision.

paid. In fiscal 1962 and 1963, $7,200 per year in rent was paid. In fiscal 1964, no rent was paid and in fiscal 1965, $553.60 was paid.

In August 1965, the property was sold to an unrelated party at a loss. Plaintiff claimed a deduction for the loss on its federal income tax return for the taxable year ending January 31, 1966. The loss deduction was disallowed on audit and taxpayer paid the additional tax which resulted. Appropriate claims for refund were filed by taxpayer and disallowed by the Internal Revenue Service. Plaintiff subsequently filed suit here seeking the refund.

The question for decision is whether Internal Revenue Code[1] § 274 bars a corporation from deducting a loss incurred in the sale of property used solely as a winter vacation residence by the corporation's shareholders.

Plaintiff contends that it is entitled to deduct the loss under I.R.C. § 165(a) which states, "There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise." This is so regardless of whether the property was used in the taxpayer's trade or business. *International Trading Co.* v. *Commissioner,* 484 F. 2d 707 (7th Cir. 1973).

Plaintiff is correct that I.R.C. § 165(a) allows the taking of a deduction for a loss such as it incurred on the sale of the Florida property. It is also correct that the Seventh Circuit held that this was so regardless of whether the property was held for use in the corporation's trade or business.

However, there is a distinguishable difference between the facts involved in *International Trading Co., supra,* and this case. That difference is the taxable year in dispute. In *International Trading Co.,* the taxable year in dispute was 1957. The taxable year in dispute here is fiscal year 1966.[2] This distinction's importance is due to the passage of I.R.C. § 274 by Congress in 1962, with an effective date of January 1, 1963. §§ 4(a)(1) and (c), Revenue Act of 1962, P.

[1] Hereinafter all Internal Revenue Code sections will be cited I.R.C. and will be to the 1954 code as amended, unless otherwise stated.

[2] Plaintiff reported its taxable income on a February 1-January 31 fiscal year basis. The taxable year in dispute is the February 1, 1965, through January 31, 1966, fiscal year.

L. 87–834, 76 Stat. 960. The Seventh Circuit acknowledged the potential impact of the enactment of section 274 on its conclusion that the loss was deductible and expressly qualified its decision in the following manner:

> * * * We reach no decision as to whether a loss of the type here involved would be deductible by a corporation after the effective date of Section 274. * * * [484 F. 2d at 712.]

Thus, the issue before this court was not reached by the Seventh Circuit.

Section 274 provides, in pertinent part, as follows:

> (a) *Entertainment, Amusement or Recreation.*—
>
> (1) *In general.*—No deduction otherwise allowable under this chapter shall be allowed for any item—
>
> (A) *Activity.*—With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, unless the taxpayer establishes that the item was directly related to, or, in the case of an item directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), that such item was associated with, the active conduct of the taxpayer's trade or business, or
>
> (B) *Facility.*—With respect to a facility used in connection with an activity referred to in subparagraph (A), unless the taxpayer establishes that the facility was used primarily for the furtherance of the taxpayer's trade or business and that the item was directly related to the active conduct of such trade or business,
>
> and such deduction shall in no event exceed the portion of such item directly related to, or, in the case of an item described in subparagraph (A) directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), the portion of such item associated with, the active conduct of the taxpayer's trade or business.

A winter vacation home is clearly a facility used in connection with an activity generally considered to constitute recreation, entertainment, or similar activity described under the terms of section 274(a)(1). Treas. Reg. §§ 1.274–2(b)(1) and 1.274–2(e)(2) (1963). Indeed, the taxpayer does not challenge the characterization of the Palm Beach

residence as an entertainment facility under section 274(a)(1). Since it is such a facility and the plaintiff has stipulated that the property was not used in its trade or business, section 274(a)(1) clearly disallows the loss deduction plaintiff claimed on its fiscal 1966 tax return.

Plaintiff has advanced several reasons why the disallowance provisions of section 274(a) should not be applied in this case. First, plaintiff claims it fits within an exception to section 274(a). I.R.C. § 274(f) states:

> (f) *Interest, Taxes, Casualty Losses, etc.*—This section shall not apply to any deduction allowable to the taxpayer without regard to its connection with his trade or business (or with his income-producing activity). In the case of a taxpayer which is not an individual, the preceding sentence shall be applied as if it were an individual.

Plaintiff contends that the first sentence of subsection (f) read in conjunction with *International Trading Company, supra,* saves it from the disallowance mandated by section 274(a). The limiting provision of subsection (f) instructs us, however, that in applying the exception a corporate taxpayer, like plaintiff, shall be treated as an individual. When this is done the limitation of I.R.C. § 165(c),[3] which applies only to individuals, again requires the loss to be incurred in the conduct of a trade or business if it is to be deductible. Since plaintiff's loss was not incurred in the conduct of its trade or business, it fails to qualify under the exception stated in I.R.C. § 274(f).[4]

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[3] I.R.C. § 165:

"(c) *Limitation on losses of individuals.*—In the case of an individual, the deduction under subsection (a) shall be limited to—

"(1) losses incurred in a trade or business;

"(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; and

"(3) losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. A loss described in this paragraph shall be allowed only to the extent that the amount of loss to such individual arising from each casualty, or from each theft, exceeds $100. For purposes of the $100 limitation of the preceding sentence, a husband and wife making a joint return under section 6013 for the taxable year in which the loss is allowed as a deduction shall be treated as one individual. No loss described in this paragraph shall be allowed if, at the time of filing the return, such loss has been claimed for estate tax purposes in the estate tax return."

[4] One instance when I.R.C. § 274(f) would help a corporate taxpayer, like plaintiff, deduct an otherwise disallowed loss is in the case of a casualty loss. Treas. Reg. §

Next plaintiff contends that section 274 was intended to disallow deductions for expenses but not losses. We do not agree. Section 274(a)(1) states that "no deduction otherwise allowable * * * shall be allowed * * *." It does not state no deduction for *expenses* otherwise allowable shall be allowed. The absence of the word "expenses" from section 274(a) is significant. Congress has demonstrated that it can limit disallowance provisions to expenses when it so intends. *See, e.g.*, I.R.C. §§ 262, 267(a)(2).[5] It is also clear from the legislative history of the Revenue Act of 1962 that Congress intended section 274 apply to losses. Both the House Ways and Means Committee Report and the Senate Finance Committee report state:

> In addition to items commonly regarded as expenses "with respect to a facility," such expenditures for maintenance, preservation, or protection of the facility, this provision also relates to depreciation and *losses realized on certain sales of entertainment facilities.* H. R. Rep. No. 1447, 87th Cong., 2d Sess. 21–22 (1962); S. Rep. No. 1881, 87th Cong., 2d Sess. 31 (1962). [Emphasis supplied.][6]

Finally, plaintiff contends that corporate taxpayers do not deduct losses realized on the sale of capital assets, but offset the losses against capital gains. I.R.C. § 1211(a). Plaintiff is correct in that I.R.C. § 1211(a) states a corporate taxpayer can deduct capital losses to the extent there are capital gains. However, before any loss can be so offset, it must be deductible under I.R.C. § 165(a). *Estate of Gutman* v. *Commissioner*, 18 T. C. 112 (1952). Since the loss involved in this case does not qualify as a deductible item, it cannot be offset against other capital gains.

The taxpayer does not raise the issue of whether the property was held in a rental trade or business after 1961. Therefore, we do not consider it.

1.274–6 (1963).

[5] Other courts have recognized and relied upon the presence or absence of the word "expenses" in a disallowance provision. *International Trading Co.* v. *Commissioner*, 484 F. 2d 707, 712 (7th Cir. 1973).

[6] Since we hold that I.R.C. § 274(a) applies to loss deductions, we reject plaintiff's argument that only I.R.C. § 274(g) applies to loss deductions.

Syllabus

CONCLUSION OF LAW

In conclusion, we hold that I.R.C. § 274(a) disallows the deduction by plaintiff of the loss incurred on the sale of the Florida property in August 1965. Since this is the sole basis upon which plaintiff's refund claim is based, plaintiff is not entitled to recover. Therefore, the petition is dismissed.

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568 F.2d 687

FRAMLAU CORPORATION v. THE UNITED STATES

[No. 274–74. Decided December 14, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; disputes; interpretation; ambiguity; changes; time extensions; delays; heating costs in winter; integral vs. monolithic construction of concrete floors and girders; interest on borrowings; debt v. equity capital.— Plaintiff contracted to build a Naval Reserve training center to be completed within a year, with liquidated damages of $200 per day thereafter. Because of certain delays for which time extensions were allowed, little more than half the work was completed before onset of a particularly severe winter. Plaintiff incurred additional costs for which it seeks recovery. The trial judge in a recommended decision (reported in full text at 23 CCF ¶ 80,823) denied all of plaintiff's claims; plaintiff's request for review thereof concerns only four counts of the petition. The central issue before the court is the interpretation of the phrase "monolithic floor construction integral with supporting beams and columns" for the upper floors of the building. The contract also provided that all construction be monolithic unless otherwise indicated. Plaintiff contends that the contract permitted it to employ any method, including use of construction joints, which would achieve integration, such as the Omnia system. Defendant insisted that the floors and girders be formed in a single pour, or two pours completed before either could cure. Plaintiff complied under protest and constructed the floors and girders monolithically; it unsuccessfully sought an equitable adjustment administratively for the increased costs of compliance. For the reasons recited, it is *held* that defendant acted within its right in insisting upon monolithic construction of the floors and girders on upper floors, that the contract appeals board's decision on this issue is factually sustainable and legally correct, and that plaintiff is not entitled to an equitable adjustment. Plaintiff also seeks delay costs and remission of liquidated damages. It is *held* that since this claim depended on plaintiff's success respecting the floor

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and girder dispute, plaintiff is not entitled to recover on this claim. Plaintiff also seeks heating costs incurred during the second winter of construction. It is *held* that since this claim depends upon the floor and girder dispute, it also fails. Plaintiff also seeks to recover interest on borrowings by reason of delays in payment and wrongful withholding of liquidated damages, such as interest on a sum which the board awarded plaintiff for changed work, and interest based on increased overhead costs awarded by the board. It is *held*, for the reasons recited, that plaintiff is not entitled to recover on its interest claims. Plaintiff urges the court to abandon the standard for award of interest enunciated in *Bell* v. *United States*, 186 Ct. Cl. 189, 404 F. 2d 975 (1968), particularly in view of the board's recent holdings allowing recovery of interest without regard to whether debt or equity capital is used. However, the court adheres to the restriction on the scope of interest recovery mandated by 28 U.S.C. § 2516(a). Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

Contracts; disputes; question of law; what constitutes.

[1] Interpretation of a contract involves an issue of law and is a proper subject for judicial determination.

Contracts ⚖176(1)

Contracts; interpretation; contract as a whole; clauses construed together.

[2] Where a contract read as a whole is amenable to only one reasonable construction, there is no need for application of rules for resolution of ambiguities against the drafter. In view of a contract provision of general applicability prohibiting use of construction joints except where approved or where shown, another provision directing that all construction be monolithic unless otherwise provided, and a combination floor provision calling for construction of a monolithic floor integral with supporting beams and columns, the requirement of approval of construction joints cannot be met by showing that "integral," standing alone, might contemplate use of joints. A more affirmative act of approval of use of construction joints was contemplated by the unambiguous contract language since "integral" may mean monolithic and an integral construction can be achieved without construction joints.

United States ⚖70(8)

Contracts; interpretation; ambiguity.

[3] Where a contractor contends for his interpretation of an alleged ambiguous Government-drafted contract, he must show that he relied on such an interpretation.

United States ⚖70(1)

Contracts; changes; time extensions; delays resulting from changes; additional heating costs.

[4] A contractor is not entitled to an equitable adjustment for unanticipated heating costs as a result of delays where the costs were incurred after the termination date of time extensions allowed for said

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delays. Under such circumstances, time extensions may not be the basis for an equitable adjustment for unanticipated heating costs.

United States ⚖70(34)

Interest; claims against United States; when allowable.

[5] 28 U.S.C. § 2516(a) prohibits this court from awarding interest on a claim except where allowed by contract or where authorized by statute. Absent such circumstances, interest for delay in payment by the United States and for liquidated damages withheld and later returned is not recoverable.

United States ⚖110

Interest; claims against United States; when allowable.

[6] Where a contractor has failed to prove that he was forced to borrow to perform changed work for which the administrative board allowed an equitable adjustment, the contractor is not entitled to recover interest on the amount of said allowance absent contractual or statutory provision therefor.

United States ⚖110

Interest; claims against United States; when allowable.

[7] Where a contractor claiming interest based on increased overhead costs awarded by the administrative board resulting from Government delays has failed to segregate recoverable amounts from borrowings attributable to extraneous, or noncompensable matters, the interest is not recoverable.

United States ⚖110

Contracts; damages; measure of damages; total cost theory.

[8] The total cost method of computing damages due a contractor for Government-caused delays is not favored by the court.

United States ⚖74(14)

Interest; claims against United States; interest on borrowings; debt v. equity capital.

[9] The allowance of interest as part of an equitable adjustment for changed work where a contractor actually paid interest on borrowings because of Government delay in payment is reasonable in that the cost to the contractor of borrowing capital is clearly determinable, whereas where equity capital is used the value to the contractor of the use thereof is not so readily ascertainable. In view of the prohibition in 28 U.S.C. § 2516(a), this court is not prepared to award interest on the use of equity capital.

United States ⚖110

D. Joe Smith, Jr., for plaintiff. *Gilbert A. Cuneo*, attorney of record. *C. Stanley Dees, Sellers, Conner & Cuneo*, of counsel.

Richard J. Webber, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before LARAMORE, *Senior Judge*, KUNZIG and BENNETT, *Judges*.

BENNETT, *Judge*, delivered the opinion of the court:

This case, arising under the Wunderlich Act, 41 U.S.C. §§ 321, 322 (1970), is before the court on plaintiff's appeal from a decision entered by Trial Judge Francis C. Browne, allowing defendant's cross-motion for summary judgment. Plaintiff does not request review of seven counts of its petition disposed of by the trial judge. What remains for our attention are counts III, VIII, X, and XI of plaintiff's petition and plaintiff's motion for summary judgment as it relates to those counts.[1] We reach the same result as the trial judge but by a somewhat different and shorter route.

Numerous issues were decided adversely to plaintiff by the contracting officer, by the Armed Services Board of Contract Appeals (ASBCA, or the board), and by the trial judge. Of the four remaining issues still contested by plaintiff, the first is of prime importance since it affects the outcome of each of the others. This dispute, which the parties have come to call the floor-and-girder issue, was resolved by the trial judge in favor of defendant. We agree with his able analysis, much of which has been included in the following discussion.

On June 29, 1967, plaintiff contracted with the Navy to build a Naval Reserve Training Center near Wilkes-Barre, Pennsylvania. Construction was to begin on the date of the contract and to be completed by June 26, 1968, with liquidated damages of $200 per day thereafter.[2] Plaintiff's delay in posting required payment and performance bonds prevented the commencement of work until July 18, 1967. Soon thereafter, a 40-day strike retarded plaintiff's progress further. For these and other reasons, little more than half the work was completed by the onset of the severe

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[1] The counts of the petition before the court, and the board citations to the issues still controverted, are:

Count III. Floor-and-girder issue. ASBCA No. 13893, 71-1 BCA ¶ 8836.

Count VIII. Delay costs and liquidated damages. ASBCA No. 14666, 72-1 BCA ¶ 9279.

Count X. Financing charges. ASBCA No. 14666, 72-1 BCA ¶ 9279.

Count XI. Heating costs. ASBCA No. 14568, 72-1 BCA ¶ 9280.

[2] Clause 3 of the contract's general provisions was the standard changes clause, and clause 6 was the standard disputes clause.

1967–68 winter, and construction was not completed until sometime in 1969. One factor bearing on the pace of performance was the Government's decision concerning the method of constructing the upper floors of the building, giving rise to the dispute aforementioned as central to this case.

The contract authorized a choice by the contractor between three methods of constructing the second and third floors. The alternatives permitted were precast, cast-in-place, and combination flooring. The first two methods of construction were described in drawings which were part of the contract; the third was not. The contract's key references to combination floor construction were in section 3C.3.1 of the specifications, which provided, *inter alia:*

> *General.* A combination floor system may be provided at the option of the Contractor in lieu of the precast and cast-in-place floor construction. The combination floor system shall consist of a joist and filler system providing monolithic floor construction integral with supporting beams and columns. * * * All work and materials shall be in accordance with the applicable requirements of specification 13Y except as modified herein.

The language most hotly debated in this case is to be found in the phrase "providing monolithic floor construction integral with supporting beams and columns," although in the view we take of the dispute, the language incorporating specification 13Y is also critical. We begin by examining the meaning of the terms "monolithic" and "integral."

The parties accept as authoritative the definitions of the Concrete Reinforcing Steel Institute (CRSI),[3] which defines the terms relevant to this dispute as follows:

> INTEGRAL—Elements which act together as a unit, such as concrete joists and top slab. Concrete members may be made integral by bond, dowels, or being cast in one piece. MONOLITHIC—Strictly interpreted, is concrete cast in one operation. Monolithic concrete elements may be designed

[3] CRSI RECOMMENDED PRACTICE FOR PLACING REINFORCING BARS— INCLUDING 1963 SUPPLEMENT (1963) (hereinafter *CRSI Handbook*) at 274, 276.

to act integrally, or as separate elements if articulated by weakened plane contraction joints. See Integrally-cast.[4]

Although plaintiff initially planned to use precast panel floors, after award it changed plans and elected to use the combination floor system for construction of the upper floors, selecting the "Omnia" system which was commercially available from Nyce-Crete Company. In September 1967 plaintiff submitted drawings illustrating the latter as its proposed construction method. The drawings showed that plaintiff would not be casting the floors and beams (also known as girders)[5] monolithically but instead would use a construction joint[6] to make them integral. Under this method plaintiff would be monolithically casting the floor, permitting it to harden, and then casting the concrete for the girders. The advantage would be that plaintiff would not need hanging forms because the forms for the girders could be set upon and supported by the floor. The drawings were approved by defendant in mid-September.

In October, however, defendant revoked its earlier approval of the drawings,[7] claiming the use of construction joints was impermissible under the contract and insisting that monolithic construction of the floors and girders was required. The Government insisted that the floor and girders be formed in a single pour, or two pours completed before either could cure,[8] believing that only monolithic construction could provide the strength necessary to ensure the soundness of the building.

Under protest, Framlau complied and constructed the floors and girders monolithically. It then sought an

[4] "INTEGRALLY-CAST—Elements (such as concrete joists and top slab) cast in one piece. See Monolithic." *Id.* at 274.

[5] "BEAM—Horizontal support or member carrying transverse loads." "GIRDER—Principal beam supporting other beams." *Id.* at 270, 273. The terms are used interchangeably in this opinion.

[6] "CONSTRUCTION JOINT—Separation between two placements of concrete; a means for keying two sections together." *Id.* at 271.

[7] Plaintiff has not contended that it was prejudiced by the Government's approval and subsequent revocation of that approval of plaintiff's proposed construction plans. Framlau's claim is based upon the Government's allegedly wrongful insistence on monolithic construction, and no claim was made that plaintiff was damaged by the Government's delay in detecting the construction joints in plaintiff's combination floor construction proposal.

[8] This latter method would achieve the same result under principles of concrete chemistry. The two pours would have to be within mere hours of each other.

equitable adjustment for the increased cost of complying with the Government's instructions. The contracting officer, the board, and the trial judge all concluded that the Government's insistence on a monolithic construction method was allowed under the contract. We agree.

We have noted that section 3C.3.1 incorporated by reference specification 13Y of the Bureau of Yards and Docks specifications. We should add that section 3C.2, also applicable only to combination floor construction, also mentioned the Bureau of Yards and Docks specifications, specifically incorporating by reference specification 13Yg thereof. The parties have stipulated that the referenced specification provides that "construction joints can only be placed or used where approved or where shown." The other important specification is in the general notes on sheet 33 of the contract documents (entitled Column Schedule & Details Structural), which provides in section 3A: "Unless otherwise indicated all construction shall be monolithic."

Plaintiff's construction of the phrase "monolithic floor construction integral with supporting beams and columns" emphasizes the word "integral." Plaintiff uses the definition cited earlier to support its contention that the contract permitted plaintiff to employ any method, including the use of construction joints, which would achieve integration. Framlau contends that defendant knew how to specify that the flooring and girders be monolithic but instead chose to require only that they be integral, leaving the requirement of monolithic construction to apply to the floor construction alone. Plaintiff argues that defendant was obligated to approve any construction method achieving integration (a result which the *CRSI Handbook* indicates could be reached with construction joints) and that defendant could not properly insist on wholly monolithic construction. Framlau invokes our rule in *WPC Enterprises, Inc.* v. *United States*, 163 Ct. Cl. 1, 6, 323 F.2d 874, 876 (1963), which would permit plaintiff to adopt any reasonable construction of an ambiguous contract provision.[9] If, as

[9] *WPC Enterprises, Inc.* was disapproved on other grounds in *United States* v. *Anthony Grace & Sons*, 384 U.S. 424, 430 n.6 (1966), but the proposition for which the case is cited in this opinion is still sound law.

This standard rule of contract interpretation has been stated in many of our cases

plaintiff argues, the Omnia plan was permissible under the contract, Framlau would be entitled to an equitable adjustment for the change instituted by defendant's insistence upon wholly monolithic construction.

Defendant responds that, while plaintiff may be entitled to call upon reasonable interpretations of contractual ambiguities, no such ambiguity exists here. That "integral with" has several possible meanings is conceded, but defendant finds two contract provisions to eliminate any ambiguity. When the contract is read as a whole, as defendant insists it must be, it admits of only one construction: that integration was to be achieved through monolithic construction. The two provisions central to this argument are, first, sheet 33, which prohibits the use of construction joints except where approved or where shown, and, second, specification 13Y, which directs that all construction be monolithic unless otherwise provided.

Plaintiff's attempts to escape the effect of these two provisions are well argued and vigorously pressed but also unavailing. We next discuss, in turn, plaintiff's answer to sheet 33's general notes and then its argument concerning specification 13Yg, incorporated by reference.

To defendant's invocation of the general notes on sheet 33, plaintiff responds that they only apply to those subjects covered by that sheet's title: Column Schedule and Details Structural. To plaintiff, this title means the general notes only apply to columns and not to the combination floor. But these notes unmistakably indicate applicability to subjects other than columns. For example, paragraph 3B of the notes refers to precast units and combination systems, although all columns were to be cast in place. Other subjects covered in the notes, such as structural steel, open web joists, and slabs on grades exposed to weather, also are irrelevant to column construction. The testimony by defendant's witness that the general notes on sheet 33 applied to the contract as a whole was undisputed and compelling.[10] If any further reason were needed, we might

and is embodied in the RESTATEMENT (SECOND) OF CONTRACTS § 232 (Tent. Draft No. 5, 1970).

[10] The trial judge used this undisputed testimony as the basis for a *finding of fact* that paragraph 3 pertains to the entire building process, including the floor-and-

add that the title itself goes beyond columns by mentioning "Details Structural." Therefore, we conclude that the combination flooring system was subject to the contract term, "Unless otherwise indicated all construction shall be monolithic."

Plaintiff next contends that the word "integral" otherwise indicates. We disagree. "Integral" indicates that integration is required but it does not foreclose inquiry into *how* it is to be achieved. We do not read it to authorize every method of construction which results in integration but rather interpret it as mandating integration in a manner otherwise permissible under the contract. The contract provision requiring monolithic construction "unless otherwise indicated" requires a more explicit authorization of nonmonolithic construction than is shown here before we will find that provision inapplicable.

This analysis is particularly forceful when applied to the provision barring construction joints except "where approved or where shown." Since there is no contention that the construction joints plaintiff wished to use were shown in contract drawings, plaintiff is left with no alternative but to argue that they were "approved." The approval, plaintiff contends, must be found in the choice of the word "integral" over the word "monolithic." But integral may mean monolithic,[11] and integral construction can be achieved without construction joints. No contract provision expressly approved the use of construction joints, and we believe specification 13Yg's requirement of approval of construction joints cannot be met by showing the use of a word which, standing alone, might contemplate their use but by no means requires it. In other words, a more affirmative act of approval was contemplated before construction joints could become permissible.[12]

girder construction. Trial judge's opin. at 40 n.23. But we treat this factual evidence, unchallenged by plaintiff, as warranting the *conclusion of law* that paragraph 3 has general applicability. That interpretation of a contract is an issue of law is well settled. *See, e.g., C.J. Langenfelder & Son* v. *United States*, 169 Ct. Cl. 465, 480, 341 F.2d 600, 609 (1965).

[11] See text relating to note 3, *supra*.

[12] We acknowledge that the language requiring approval is not as unequivocal as that found in *WRB Corp.* v. *United States*, 183 Ct. Cl. 409, 480–83 (1968), where the contract said: "No construction joints will be allowed in buildings, except with special permission of the contracting officer." Nonetheless, we believe the language

Plaintiff tries to avoid this reasoning by contending that specification 13Y is general while the "integral with" phrase is specific. If true, this fact would permit plaintiff to avail itself of the rule that specific contract provisions override general ones to the contrary. *United Pac. Ins. Co.* v. *United States*, 204 Ct. Cl. 686, 694, 497 F.2d 1402, 1406 (1974); *Hol-Gar Mfg. Corp.* v. *United States*, 169 Ct. Cl. 384, 396, 351 F.2d 972, 980 (1965). But two sound reasons prevent that rule's application here. First, there need be no conflict between the "general" provisions and the specific one if defendant's construction is adopted. Here, the disputed provision is admittedly ambiguous when read by itself. But the two provisions relied on by defendant eliminate any ambiguity in the word "integral." Where a contract read as a whole is amenable to only one reasonable construction, we have no need for application of rules for the resolution of ambiguities against the drafter. *Martin Lane Co.* v. *United States*, 193 Ct. Cl. 203, 218, 432 F.2d 1013, 1021 (1970); *Bishop Eng. Co.* v. *United States*, 180 Ct. Cl. 411, 415–16 (1967); *Construction Serv. Co.* v. *United States*, 174 Ct. Cl. 756, 760, 357 F.2d 973, 975 (1966).

Second, specification 13Y is not a general provision dredged up from some obscure corner of the contract. To the contrary, it is *specifically* cited and incorporated by reference in the very paragraph which authorized the combination floor system. On the same page, specification 13Yg is again invoked to establish standards for concrete construction of the combination floor system. These facts convince us that no ambiguity exists and that defendant's interpretation is the only reasonable one when the contract is read as a whole.

Finally, plaintiff makes much of the fact that columns were subject to the same contract provision as supporting beams. That is, the contract required "monolithic floor construction integral with" the vertical members, whether beams or columns. Yet, plaintiff observes, defendant permitted the use of construction joints in regard to *columns* and did not require monolithic construction of

here was sufficiently clear to warrant the same result, i.e., a finding that the contract did not permit the use of construction joints.

columns and floors. Therefore, plaintiff argues, defendant's own interpretation shows the *beams* did not have to be constructed monolithically with the floor.

Defendant's answer at oral argument shows this argument to be fallacious. All columns were shown on contract diagrams as having construction joints. The authority to make the columns integral, but not monolithic, with upper-story flooring came not from the contractual provision relied on by plaintiff but from the *drawings* which specifically authorized the use of construction joints with columns. Indeed, one could not readily make the columns monolithic with the flooring and beams, since even more extensive use of hanging forms would be necessary; virtually the entire structure of the building would have to be poured, all at once, from the top. Quite reasonably, the contract drawings expressly indicated that columns could be poured first and that construction joints could be used to achieve integration of columns, but not beams, with upper-story flooring.

With respect to *columns*, both the requirement of monolithic construction and the prohibition against construction joints were expressly made inapplicable. Nothing that plaintiff can point to warrants the same conclusion concerning *beams*. With respect to the latter, there was less need and no authorization to use construction joints or to permit nonmonolithic construction.

An additional ground for denying plaintiff's claim is plaintiff's lack of reliance on its claimed interpretation of the contract provision. It is well settled that where a contractor contends for his interpretation of an alleged ambiguous contract, he must show that he relied on such an interpretation. *Dale Ingram, Inc.* v. *United States*, 201 Ct. Cl. 56, 72, 475 F.2d 1177, 1185 (1973), and cases there cited. But plaintiff has not, and cannot, show that it relied on its interpretation of the phrase concerning monolithic floor construction. Surely it did not rely on such an interpretation when making its bid. The board found that at the time of bid preparation plaintiff was planning to use precast construction, not combination construction. And plaintiff did not rely on the interpretation during perform-

ance, for plaintiff was informed in October of 1968 that wholly monolithic construction was required.[13] Plaintiff chose not to return to its plan to construct the floors according to the precast method upon which it based its bid.

The foregoing analysis leaves us with no doubt that defendant acted within its rights under the contract when it insisted upon monolithic construction of the floors and girders on upper floors. Therefore, plaintiff was entitled to no equitable adjustment for being denied permission to construct the upper floors according to the Omnia construction plan. On this point, the board's decision is factually sustainable and legally correct.

Plaintiff's next claim is for delay costs and remission of liquidated damages. Of the numerous delays claimed in board proceedings only one 12-day claim is before the court.[14] Plaintiff spent 12 days in the spring of 1968 on site restoration, repairing damage caused by the heavy winter. Some of this period was spent repairing hanging forms which would not have been used if plaintiff's proposed construction method had been permitted.[15] Plaintiff contends that defendant is chargeable with the delays, alleging that the failure to be under roof by winter was due to defendant's insistence on wholly monolithic floor-and-girder construction.

Plaintiff, at argument, conceded that its entitlement to additional delay damages and to remission of liquidated damages for this period is dependent upon its success concerning the floor-and-girder dispute. Since we find for defendant upon that issue, this one requires no further discussion.

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[13] See footnote 7, *supra*.

[14] Plaintiff has told the court that its second, third, and fourth appeals here are not separate claims for relief based on distinct "changes" but rather were brought to preserve any rights plaintiff may have had to a complete equitable adjustment for damages resulting from the Government's insistence on monolithic floor-and-girder construction.

[15] Defendant contends that its authorization to plaintiff to cast the floors and girders with two pours within hours of each other made the use of hanging forms unnecessary, a contention with which plaintiff disagrees. Since we find that the contract permitted defendant's insistence upon monolithic construction, this issue becomes immaterial.

Plaintiff also seeks compensation for heating costs incurred during the second winter of construction. This claim is likewise dependent upon the first issue concerning the floor and girders. No heating costs were incurred until more than 2 months *after* the termination date of the constructive completion schedule created to allow for all extensions due under adjustments awarded by the board. Not having prevailed on its floor-and-girder claim, plaintiff cannot possibly extend the constructive completion schedule up to the time when heating costs were first incurred. Therefore, this claim, like the delay cost and liquidated damage claim, must fall with the floor-and-girder argument.

Plaintiff's last claim is for interest on borrowings. Although the size of this claim is affected by the outcome of the floor-and-girder dispute, the fragmented nature of this claim requires separate treatment of component elements. Plaintiff's interest claim results from late payment and the withholding of liquidated damages (some of which were later returned) in addition to awards for changed work and overhead costs. These will be taken up in turn.

Plaintiff's argument claiming entitlement to interest for delays in payment and for the wrongful withholding of liquidated damages asks that we award plaintiff interest under circumstances in which we have not previously done so. *Bell* v. *United States*, 186 Ct. Cl. 189, 206, 404 F.2d 975, 984 (1968), said that the board could award interest as part of an equitable adjustment for changed work where a contractor actually paid the interest because of the Government's delay in payment. But we have never extended *Bell* to allow the recovery of interest on liquidated damages withheld and later returned or for late payments by the United States. *See Mar-Pak Corp.* v. *United States*, 203 Ct. Cl. 718, 720 (1973). Our reason for restricting the scope of interest recovery is the bar erected by 28 U.S.C. § 2516(a)(1970), which denies this court power to award interest except where allowed by contract or where authorized by statute. Since plaintiff here has the

benefit neither of a contract nor a statute providing for the recovery of interest, no interest can or will be awarded.[16]

Plaintiff also asks that we order the board to award interest on the $745.17 which the board awarded to plaintiff for changed work. Under *Bell, supra,* an equitable adjustment could have included such an amount if plaintiff could have proved it was forced to borrow to perform the changed work. But the board found that plaintiff failed to prove what part, if any,[17] of its large borrowings were attributable to compensable changes. This failure deprived plaintiff of the opportunity to recover any interest. For this reason, we affirm the board's denial of interest on changed work.

Similar reasoning undermines plaintiff's claim for interest based on increased overhead costs awarded by the board to plaintiff in the amount of $3,500. Again, the board's denial of interest was premised on its finding that plaintiff failed to segregate recoverable amounts from borrowings attributable to extraneous, or noncompensable, matters. Plaintiff's interest claim was brought to the board as part of its delay claim, which was presented to the board on a total time basis.[18] Plaintiff did not prove which delays or which borrowings were properly attributable to the Government. For this reason, substantial evidence supports the board's conclusion that entitlement to interest was not proved.

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[16] The harshness of the statutory mandate appears to have been eased as to contracts entered into on or after Oct. 12, 1972. On that date, the Armed Services Procurement Regulations (ASPRs) were amended to authorize the payment of interest on claims arising under a contract from the time of the contractor's appeal to the contracting officer until the final judgment of a court of competent jurisdiction. 32 C.F.R. §§ 1–333, 7–104.82 (1975); *cf.* 41 C.F.R. § 1–1.322 (1976). Such departmental regulations are treated by this court as law governing the interpretation of Government contracts. *Hills Transp. Co.* v. *United States,* 204 Ct. Cl. 51, 55, 492 F.2d 1394, 1396–97 (1974). In contrast to that case, however, this one presents a regulation which is *prospective* only; since it was inapplicable to contracts existing before but amended after the regulation's promulgation, 32 C.F.R. E–621(4)(1975), *a fortiori* the regulation cannot apply to unamended contracts existing before Oct. 12, 1972.

[17] As the Government points out, it is doubtful that plaintiff could show any borrowing was necessitated by such a small increase in contract costs as was here approved for changes.

[18] Such presentations are ill favored as a method of proving damages. *Law* v. *United States,* 195 Ct. Cl. 370, 382 (1971); *WRB Corp.* v. *United States, supra,* 183 Ct. Cl. at 427.

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Since the board's denial of interest on overhead and changes expenses was based on plaintiff's failure of proof concerning plaintiff's borrowings,[19] plaintiff urges that we abandon the *Bell* standard and follow the board's recent cases[20] allowing recovery of interest without regard to whether debt or equity capital is used. This we are not prepared to do. It may be argued that differing treatment of debt and equity capital follows an artificial distinction and that it rewards thin capitalization, but we are constrained by the statute discussed earlier and further believe that the distinction is supported by reason in that the cost to the contractor of borrowing capital is clearly determinable, while the value to him of the use of equity capital is not so readily ascertainable.

We thus conclude that the denial of interest was correct.

For the foregoing reasons, we find that the board and the trial judge were correct in determining that the contractor is not entitled to recover on any of its claims. Plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted, and plaintiff's petition is dismissed.

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567 F.2d 377

SERVICE ARMAMENT CO., FOR ITSELF AND AS SUCCESSOR IN INTEREST TO NAVY ARMS CO., INC. v. THE UNITED STATES

[No. 348-76. Decided December 14, 1977]*

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Taxes; excise tax; antique and replica firearms.—Plaintiff is an arms manufacturer and importer, whose prime business is the distribution and sale of muzzle-loading replicas of antique firearms in which powder

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[19] For the trial judge, the important factor was the insignificant amount of interest which would have been involved.

[20] *Fischbach & Moore Int'l Corp.*, ASBCA No. 18146, 77-1 BCA ¶ 12,300; *New York Shipbuilding Co.*, ASBCA No. 16164, 76-2 BCA ¶ 11,979; *Ingalls Shipbuilding Div., Litton Sys., Inc.*, ASBCA No. 17717, 76-1 BCA ¶ 11,851.

* On March 14, 1978 plaintiff filed a petition for writ of certiorari.

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and a projectile are inserted and the powder is ignited through use of a flint or cap. Plaintiff seeks to recover excise taxes imposed under Sec. 4181 of the Internal Revenue Code, claiming, *inter alia*, that by the statutory changes made in 1954 and 1968 in the definition of "firearms" (26 U.S.C. §5848 (1964 ed.)), Congress evinced an unmistakable intent to relieve antique and replica firearms from excise tax imposition. Upon review of the legislative history and statutory language of 26 U.S.C. §§ 4181, 5848 (predecessor of § 2733), 5845 (which replaced § 5848), relevant regulations, and other statutory enactments, it is *held* that the subject antique firearms, having the capacity to fire projectiles, are "firearms" within the meaning of §4181 and are subject to the tax imposed upon their sale by plaintiff. The petition is dismissed.

Court of Claims jurisdiction; declaratory judgment.

[1] This court does not have jurisdiction to render declaratory judgments except in certain tax cases as provided in the Tax Reform Act of 1976, 26 U.S.C. § 7428.

Federal Courts ⚿1078

Pleading and practice; defenses; motion for judgment on the pleadings.

[2] If, on a motion for judgment on the pleadings, matters outside the pleadings are presented to and are not excluded by the court, the motion shall be treated as one for summary judgment. Rule 38(c).

Federal Courts ⚿1120

Taxes; excise tax; firearms.

[3] Section 5848 of the Internal Revenue Code (68A Stat. 726), was enacted to relieve antique gun collectors from certain restrictions imposed upon them by prior law, but neither the legislative history nor the statutory language indicates that Congress intended to exempt antique firearms from the excise tax imposed by Sec. 4181 enacted concurrently.

Internal Revenue ⚿1111

Taxes; excise tax; firearms.

[4] There is nothing in new Sec. 5845 of the Internal Revenue Code respecting the definition of "firearms" as part of the Gun Control Act of 1968, enacted for purpose of fighting crime, or its legislative history, to indicate that the term was intended to apply to or affect an excise tax provision enacted for the purpose of producing revenue for the federal treasury.

Internal Revenue ⚿1111

Taxes; statutes; construction and operation; reenactment without change.

[5] The reenactment of a taxing statute without substantial amendment, plus the Treasury's long-standing and consistent interpretation, is deemed to have received congressional approval.

Statutes ⚿245

Conservation; excise tax revenue; disposition of unexpended funds.

[6] There is nothing in the Act of September 2, 1937, 16 U.S.C. § 669b, setting aside the proceeds of the firearms excise tax for aid in wildlife

Opinion of the Court

restoration or its legislative history, to indicate that Congress intended to amend the excise tax law enacted in 1932 to tax only weapons used in hunting wild animals. Moreover, there is no legal requirement that a taxpayer be the direct beneficiary of a tax.

Internal Revenue ⇐1111

Jerald D. Baronoff for plaintiff. *Clive S. Cummis*, attorney of record. *Sills, Beck, Cummis, Radin & Tischman*, of counsel.

George L. Squires, with whom was *Assistant Attorney General M. Carr Ferguson*, for defendant. *Theodore D. Peyser*, of counsel.

Before COWEN, *Senior Judge*, DAVIS and NICHOLS, *Judges*.

COWEN, *Senior Judge*, delivered the opinion of the court:

Plaintiff, a manufacturer and importer whose business involves the sale of muzzle-loading replicas of antique firearms, brought this action to recover excise taxes assessed against and paid by it for the second quarter of 1969 through the third quarter of 1972, in the amount of $226,113.84, plus interest. The sole issue is whether plaintiff's products are subject to the excise tax imposed by 26 U.S.C. § 4181.

The defendant filed a motion for partial summary judgment on the ground that plaintiff's claims for a refund were not timely with respect to the following:

(a) Amounts claimed by plaintiff for the fourth quarter of 1968 except for $67.99 paid on November 1, 1971.

(b) Amounts claimed by plaintiff for the first quarter of 1969 except for $321.24 paid on March 20, 1972.

(c) Amounts claimed by plaintiff for the second quarter of 1969 except for $335.35 paid on September 1, 1971.

(d) Amounts claimed by plaintiff for the third quarter of 1969 except for $330.88 paid on September 1, 1971.

(e) Amounts claimed by plaintiff for the fourth quarter of 1969 except for $335.06 paid on March 3, 1972.

Plaintiff responded with a cross-motion for summary judgment seeking recovery of the total amount of excise taxes covered by its claims for refund.[1]

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[1] In its motion, plaintiff also seeks a declaratory judgment that its sale and

Thereupon, the government filed a motion for judgment on the pleadings, which we treat as a cross-motion for summary judgment, because the Government has relied on material outside the pleadings.[2] At oral argument, plaintiff conceded that defendant's motion for partial summary judgment should be granted.

The facts essential to our decision are not in dispute. The taxpayer is an arms manufacturer and importer, whose business involves the sale of replicas of antique firearms to customers desiring them for collection, cultural, and sporting purposes. Taxpayer's prime business is the distribution and sale of muzzle-loading replicas of antique firearms in which powder and a projectile are inserted and the powder is ignited through the use of a flint or cap.

The precise issue in this case has been decided in favor of the Government in a memorandum opinion[3] of September 13, 1977 by Honorable John F. Grady, Judge of the United States District Court for the Northern District of Illinois, Eastern Division, in Docket No. 74 C 3576, *Mars Equipment Corp. v. United States.* We concur in both the reasoning and the result reached by the District Court and therefore enter a judgment denying plaintiff's motion for summary judgment and granting both of defendant's motions.

However, since some contentions have been made to us that were apparently not raised in the District Court, we shall set forth the basis for our decision in somewhat greater detail than was done in the memorandum opinion of the District Court.

I.

Section 4181 of the Internal Revenue Code imposes a tax on the sale by a manufacturer, producer or importer of firearms (other than pistols and revolvers) and on shells

importation of replica firearms is not subject to § 4181. This court does not have jurisdiction to render declaratory judgments except in certain tax cases as provided in 26 U.S.C. § 7428 (Tax Reform Act of 1976), but we may disregard this request for relief, because we have jurisdiction of plaintiff's action for the refund of excise taxes paid if a timely claim for refund has been filed.

[2] Our Rule 38(c) provides: "If, on a motion for judgment on the pleadings, matters outside the pleadings are presented to and are not excluded by the court, the motion shall be treated as one for summary judgment * * *."

[3] (1977) 77-2 U.S.T.C. (CCH) para. 16273.

and cartridges of 11 percent.[4] 26 C.F.R. § 48.4181–2 promulgated pursuant to section 4181 defines firearms and shells as follows:

> (c) *Firearms.* The term "firearms" means any portable weapons, such as rifles, carbines, machine guns, shotguns, or fowling pieces, from which a shot, bullet, or other projectile may be discharged by an explosive.
> (d) *Shells and cartridges.* The terms "shells" and "cartridges" include any combination of projectile, explosive, and container which is designed, assembled, and ready for use without further manufacture in firearms, including pistols and revolvers.

It is undisputed that the products against which the tax was assessed and collected are firearms and the plaintiff here admits that both antique and replica firearms, as manufactured and distributed by it, are capable of exploding a projectile from barrels and therefore that these articles fall clearly within the definition of "firearms" in the regulation.

II.

In an effort to show that its antique guns and their replicas are not subject to the excise tax, plaintiff has advanced a number of contentions. Its major argument is that by statutory changes made in 1954 and 1968 in the definition of "firearms," Congress evinced an unmistakable intent to relieve the antique and replica firearms from the onus of excise taxation. In order to deal with this contention, it is necessary to consider the legislative history of section 4181 and its predecessors, Chapter 53 of the Internal Revenue Code of 1954 (which replaced Chapter

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[4] 26 U.S.C. § 4181 provides:
"There is hereby imposed upon the sale by the manufacturer, producer, or importer of the following articles a tax equivalent to the specified percent of the price for which so sold:
"Articles taxable at 10 percent—
"Pistols.
"Revolvers.
"Articles taxable at 11 percent—
"Firearms (other than pistols and revolvers).
"Shells, and cartridges."

25 of the Internal Revenue Code of 1939), and the Gun Control Act of 1968, 82 Stat. 1213.

The National Firearms Act (48 Stat. 1236) was approved June 26, 1934. Its primary purpose was to make it "more difficult for the gangster element to obtain certain types of weapons." *See* S. Rep. No. 1303, 86th Cong., 2d Sess. p. 2 (1960–1 C.B. 848, 849). Part of the National Firearms Act was codified in section 2733(a) of the Internal Revenue Code of 1939 (26 U.S.C. 1952 ed.). In section 2733(a), firearms were defined to include all weapons, except pistols and revolvers, from which a shot is discharged by an explosive if the weapon is capable of being concealed on the person. This provision was interpreted by the Treasury Department to include antique and replica firearms.

Plaintiff relies on section 5848 of the Internal Revenue Code of 1954 (68A Stat. 726), which amended section 2733 of the 1939 Code to exclude antique firearms by providing that "weapon" as therein defined does not include one which is not capable of being fired with fixed ammunition. Congress stated that the purpose of the change in definitions as set forth in new section 5848 was as follows:

§ 5848. Definitions

> This section is the same as present section 2733, except that three new provisions have been added which define "rifle," "shotgun," and "any other weapon." These new definitions are needed for the reason that Congress did not define such weapons when the National Firearms Act was enacted in 1934 although it did define "machine-gun." Since Congress did not define these weapons it has been necessary to use the ordinarily accepted definitions thereof appearing in acceptable, standard dictionaries. In so doing, and because of a technical application of the definition of the term "firearm," as it appears in the present statute, many weapons firing projectiles by the action of an explosive have been brought within the scope of the National Firearms Act although it is believed the Congress did not intend that such weapons should be included. For example, under a technical interpretation of the term "firearm," blunderbusses, muzzle-loading shotguns, and other ancient or antique guns have been considered subject to the National Firearms Act and in many instances the requirements thereof have been imposed. As a result of these interpretations, over a period of years, restrictions

have been imposed on a certain class of persons, namely, antique gun collectors, and it is felt that these restrictions should be removed in pursuance of the clearly indicated congressional intent to cover under the National Firearms Act only such modern and lethal weapons, except pistols and revolvers, as could be used readily and efficiently by criminals or gangsters. Moreover, for proper administration of the National Firearms Act it is considered highly proper and desirable that the Congress define the terms "rifle," "shotgun," and "any other weapon" so as to remove any doubt as to the type of firearms which Congress intended to bring within the scope of the National Firearms Act. [H.R. Rep. No. 1337, 1954 *U.S. Code Cong. and Adm. News*, p. 4542, 83d Cong., 2d Sess.].

Prior to the 1954 amendment, antique gun collectors and other owners of these weapons were subject to a number of restrictions imposed by the National Firearms Act, which had been codified in Chapter 25, Subchapter B of the Internal Revenue Code of 1939 (26 U.S.C. 1952 ed.). These included a requirement for the registration of a firearm by every person possessing one (section 2720(d)); a provision declaring it to be unlawful for any person to transfer a firearm except on a written order set forth on an application form issued by the Commissioner (section 2723), and a provision making it unlawful to possess any firearm transferred in violation of the provisions of Subchapter B or to change the identification marks on any firearm (section 2726(a) and (b)). Penalties were prescribed for violations of the provisions of Subchapter B (section 2729) and for the forfeiture of any firearm transferred in violation of the provisions of that subchapter (section 2730). These restrictions were re-enacted without substantial change in 1954 in Chapter 53 of the Code. Some of the same restrictions were also re-enacted in the Gun Control Act of 1968 and are codified in Chapter 53 of the Code.

We think it is apparent from the legislative history cited above that section 5848 was enacted to relieve antique gun collectors from the restrictions imposed upon them by prior law, and we find nothing in the legislative history or the language of the amendment to indicate that Congress intended to exempt antique firearms from the tax imposed by section 4181 of the 1954 Code, which was passed at the

same time. Plaintiff agrees that the "manufacturer's excise tax applicable to firearms was routinely re-enacted in the 1954 Code and renumbered as § 4181."[5] As we shall show, *infra*, Congress is deemed to have been aware in 1954 of a 1935 Treasury regulation which defined firearms in language which included the firearms in issue here.

Plaintiff also relies heavily on the Gun Control Act of 1968 (82 Stat. 1213) which contained a general revision of Chapter 53 of the Code. The revision included a new section 5845 (codified as 26 U.S.C. § 5845) which replaced section 5848 for the definition of firearms. Section 5845(a) provides in part as follows:

> * * * The term "firearm" shall not include an antique firearm or any device (other than a machinegun or destructive device) which, although designed as a weapon, the Secretary or his delegate finds by reason of the date of its manufacture, value, design, and other characteristics is primarily a collector's item and is not likely to be used as a weapon.

In subsection (g) of section 5845, "antique firearm" is defined as a firearm or replica thereof which was not designed or redesigned for using rim fire or conventional center fire ignition with fixed ammunition.

Section 5845 excludes antique weapons and replicas thereof from the definition of firearms for the purposes of the other provisions of Chapter 53 of the Code. However, the declared purpose of the Gun Control Act of 1968 is "to provide support to Federal, State, and local law enforcement officials in their fight against crime and violence * * *." (82 Stat. 1213). Plaintiff has pointed to nothing in the language of the statute or its legislative history, which indicates that a definition in a law enacted to fight crime was intended to apply to or affect an excise tax provision which was enacted for the purpose of producing revenue. The language of section 5845 is to the contrary, for its opening line reads: "For the purpose of this chapter—." Without more, this express limitation is sufficient to convince us that section 5845 was not intended to apply to section 4181, which is contained in Chapter 32 of the Code, entitled "Manufacturers Excise Taxes."

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[5] Plaintiff's Brief at p. 12.

In contrast to plaintiff's failure to furnish any persuasive support for its position in the cited portions of the 1954 and 1968 Acts, we find that the legislative re-enactment of the excise tax on firearms, coupled with a consistent administrative interpretation over a period of many years, strongly supports the Government's contentions.

An excise tax on firearms was first enacted in the Revenue Act of 1918 (40 Stat. 1122) to raise revenues to defray war expenses. This law continued in effect until 1926 when the tax on firearms (except pistols) was eliminated. Because of the reduction in receipts from income taxes as a result of the depression, Congress again imposed the excise tax on firearms in the Revenue Act of 1932, 47 Stat. 264. *See* H.R. Rep. No. 708, 72d Cong., 1st Sess., pp. 3, 8 (1939–1 C.B. (Part 2)) 457, 458–59, 463. The statutory language was almost identical to that in current section 4181.

In 1935, the Treasury Department issued Article 58, Treas. Reg. 46, defining the term "firearms" as used in the 1932 Act as follows:

> The term "firearms" as used in the Act includes all portable weapons, such as rifles, carbines, machine guns, shotguns, and fowling pieces, from which a shot, bullet, or projectile may be discharged by an explosive.

In 1960, Treasury promulgated the current regulation, section 48.4181–2(c), quoted *supra*. The definition of firearms therein is virtually identical to that set forth in the 1935 regulation.

Thus, the definition of "firearms" in the regulations has remained with no significant change since 1935. The reenactment in section 4181 of prior law without substantial amendment, plus the Treasury's long-standing and consistent administrative interpretation, must be deemed to have received Congressional approval. *United States v. Leslie Salt Co.*, 350 U.S. 383, 396–97 (1956); *Knapp King-Size Corp. v. United States*, 208 Ct. Cl. 533, 548; 527 F. 2d 1392, 1400 (1975).

The consistent administrative interpretation of section 4181 is further demonstrated by a revenue ruling that has been outstanding for almost 20 years. Rev. Rul. 57–606, 1957–2, C.B. 733 provides as follows:

Whether a firearm is an antique is immaterial in determining the applicability of the manufacturers excise tax. Accordingly it is held that sales of antique firearms by an importer are subject to the manufacturers excise tax imposed by section 4181 of the Code.

Rev. Rul. 74–137, 1974–1, C.B. 313 also relates to the excise tax on replicas of antique pistols, revolvers and rifles, and reaches the same conclusion.

III.

Plaintiff's next challenge to the taxability of its products is based on the Act of September 2, 1937, 50 Stat. 917 (codified at 16 U.S.C. § 669b), which set aside the proceeds of the firearms excise tax for the aid of wildlife restoration projects. On account of the earmarking of the tax collections, plaintiff argues that the tax became, in effect, a user charge imposed on hunters who are the prime beneficiaries of Federal expenditures for wildlife restoration, and consequently, that only firearms used in hunting should be subjected to the tax.

Plaintiff maintains that since those who purchase replicas of antique firearms are seldom beneficiaries of the wildlife restoration projects, Congress did not intend that the excise tax should be borne by owners of antique weapons. This is an interesting and ingenious argument, but we reject it, because there is nothing in either the language or the legislative history of 16 U.S.C. § 669b to indicate that Congress intended to amend the excise tax law enacted in 1932 to tax only weapons used in hunting wild animals. Moreover, as the District Court observed in *Mars Equipment Corp. v. United States, supra,* there is "no legal requirement that the taxpayer be the direct beneficiary of a tax."

IV.

Plaintiff's final argument is that Congress intended a congruency between the firearms and the ammunition which are taxed in section 4181. Specifically, plaintiff asserts that "the plain meaning and objective of taxing shells and cartridges, as well as firearms, is to tax those

Syllabus

shells and cartridges which are used within those firearms." Plaintiff calls attention to 18 U.S.C. § 845(a)(5), which exempts from the regulatory provisions on explosives the purchase of commercially manufactured black powder and certain igniters in amounts not exceeding 5 pounds, where these are intended to be used for sporting, recreational, or cultural purposes in antique weapons.

Since section 4181 does not include within its terms commercially manufactured black powder and percussion caps, the only ammunition which antique firearms are designed to use, plaintiff says that it follows that Congress did not intend to tax antique weapons. Although there is some logic in this argument, it is far outweighed by the other factors which we have discussed above. Those factors more directly and specifically reveal the Congressional intent to tax the firearms in issue. Therefore, we cannot accept plaintiff's argument as a basis for decision.

CONCLUSION

It follows from the foregoing opinion that plaintiff's motion for summary judgment is denied; defendant's motion for partial summary judgment and its motion for judgment on the pleadings, which we have treated as a motion for summary judgment, are granted and plaintiff's petition is dismissed.

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568 F.2d 722

KREKEL KARCH v. THE UNITED STATES

[No. 298–69. Decided December 14, 1977]*

ON THE PROOFS

Patents; validity; obviousness.—Plaintiff seeks reasonable and entire compensation for the alleged use by the United States of his invention relating to erosion and flood prevention and control, and land reclamation, disclosed and claimed in patent No. 2,745,768. Defendant argues that the claimed process was known or used in public or

* On March 14, 1978 plaintiff filed a petition for writ of certiorari.

Syllabus

described in a printed publication within the meaning of 35 U.S.C. § 102(a), and that the invention was obvious to one of ordinary skill in the art within the meaning of 35 U.S.C. § 103. Plaintiff states that methods whose utility is limited to unusually heavy rain conditions are not within his method which is limited to collection of silt in normal, everyday intensity rains. Reading plaintiff's method to be ineffective in heavy rain situations, it is *held* that the flood control projects cited by defendant which collect silt only incidentally and occasionally do not operate in the manner required of the claim in suit, and thus such projects do not anticipate within the meaning of Sec. 102(a). After reviewing the differences between the prior art and the claim, the level of ordinary skill in the art, and the scope of the prior art, and after noting that such secondary considerations as are present are insufficient to outweigh other factors, it is *held* that the patent is invalid under Sec. 103. Plaintiff is not entitled to recover and the petition is dismissed.

Patents; specification and claims; construing and interpreting.

[1] The specification of a patent is to be looked to in determining the metes and bounds of a claim.

Patents ⚖167(1)

Patents; patentability; obviousness; generally.

[2] In evaluating validity under 35 U.S.C. § 103, it is necessary to consider the scope of the prior art, the differences between the prior art and the claims in issue, and the level of ordinary skill in the art.

Patents ⚖18

Patents; patentability; evidence of patentability; secondary considerations.

[3] Secondary considerations, such as commercial success, satisfying a long-felt need, the failure of others, or contemporaneous reactions of experts, reflect upon the determination of obviousness of an invention under 35 U.S.C. § 103. Where obviousness is clear, such secondary considerations cannot turn invalidity into validity.

Patents ⚖16.7, 18, 36.2(1)

Patents; patentability; obviousness; generally.

[4] It is essential in evaluating an invention against the standards of 35 U.S.C. § 103 that hindsight and the disclosure of the patent in suit not be resorted to.

Patents ⚖18

Patents; patentability; commercial success.

[5] To be of value on the issue of obviousness, commercial success must be shown to be attributable to the patentee's particular claimed contribution.

Patents ⚖18, 36.2(1)

John E. Juergensmeyer, attorney of record, for plaintiff. *Juergensmeyer, Zimmerman & Smith, John Carlon* and *Carlon and Carlon*, of counsel.

Frank R. Perillo, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before COWEN, *Senior Judge,* DAVIS and KUNZIG, *Judges.*

PER CURIAM: Trial Judge Colaianni has decided that plaintiff's patent relating to erosion and flood control and land reclamation is invalid for obviousness. Plaintiff has excepted to that determination. The court has considered the briefs and oral argument, and now adopts the trial judge's opinion (with minor modifications) as hereinafter set forth, as the basis for its judgment in the case.* Accordingly, it is concluded that plaintiff is not entitled to recover and the petition is dismissed.

Trial Judge Colaianni's opinion, with minor modifications, is as follows:

COLAIANNI, *Trial Judge:* Charging that the United States has used the invention covered by his patent, entitled "Erosion and Flood Control and Land Reclamation," without his consent or authorization, plaintiff brings this action pursuant to 28 U.S.C. § 1498 for reasonable and entire compensation. Trial was limited to the issues of patent validity and infringement. The amount of plaintiff's recovery, if any, is deferred until after a final ruling by this court on the questions of validity and infringement.

The patent in suit, United States Patent No. 2,745,768, hereinafter referred to as the "Karch" patent, issued on May 15, 1956,[1] to Krekel Karch, who throughout its term was the sole owner of all right, title and interest therein.

Defendant denies plaintiff's claim on various grounds, including that the claimed process was known or used in public, or described in a printed publication within the meaning of 35 U.S.C. § 102(a),[2] more than 1 year prior to

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* While the court adopts the trial judge's separate findings of fact, as set forth in his report filed January 27, 1977, they are not printed herein since such facts as are necessary to the decision are contained in the opinion set forth *infra.*

[1] The term of a patent is 17 years; accordingly, the Karch patent expired on May 15, 1973.

[2] "§ 102. Conditions for patentability; novelty and loss of right to patent

"A person shall be entitled to a patent unless—

"(a) the invention was known or used by others in this country, or patented or described in a printed publication in this or a foreign country, before the invention

the date of plaintiff's invention. In addition, defendant urges that the invention was obvious to one of ordinary skill in the art and thus invalid for failure to meet the standard of 35 U.S.C. § 103.[3] Finally, defendant maintains that it is not liable to plaintiff because it has not used the process covered by the single process claim of the Karch patent during the relevant accounting period.

For the reasons stated hereinafter, it is concluded that the patent in suit is invalid since the process would have been obvious to one of ordinary skill in the art at the time that plaintiff made his invention.

The Karch Patent

The Karch patent relates to erosion and flood prevention and control, and, as well, to the reclamation of land which has been damaged by the failure of a landowner to practice necessary water control measures. Briefly stated, the method employs the well-known concept of slowing the velocity of silt-laden water to such a degree and for such a length of time, that a large proportion of the silt will be deposited. A substantial proportion of the desilted water is soaked up by the terrain to increase the land's water table, while the remainder harmlessly passes along its normal flow course. In order to collect and otherwise slow the velocity of the silt-laden water, a barrier is constructed across a gully that is to be eradicated. In this manner, a dry basin is formed behind or upstream of the barrier. Prior to forming the barrier, a horizontal conduit has been placed such that it will ultimately be positioned transversely below the barrier. The inlet of the conduit is placed at approximately the lowest level of the dry basin, while the outlet may discharge into another dry basin, stream, or lake.

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thereof by the applicant for patent, or"

[3] "§ 103. Conditions for patentability; non-obvious subject matter

"A patent may not be obtained though the invention is not identically disclosed or described as set forth in section 102 of this title, if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains. Patentability shall not be negatived by the manner in which the invention was made. * * *."

The arrangement is such that in times of rainfall water will flow rapidly down the gully, at a velocity that is dependent upon such factors as the amount of rainfall and the slope of the gully. The water carries in suspension soil or silt washed from the land drained by the gully. Upon the silt-laden water initially reaching the barrier, its movement will be interrupted and a pool will be formed in the basin. The slowing of the water results in the deposition of suspended silt. As additional water enters the basin, it encounters the water previously collected and in turn is sufficiently slowed so that its silt will be deposited on the floor of the gully at the point on the periphery of the water present in the basin where the additional silt-laden water enters. As additional water is collected, the periphery of the pool is continuously changing, so that successive increments of silt will be deposited at the everchanging water periphery.

The water which is collected in the basin will be discharged by way of the conduit. However, the conduit inlet can be restricted so that the rate of discharge through the conduit is substantially less than the normal rate of flow into the basin. In this manner, even normal rains will cause a pool or lake to be formed temporarily in the dry basin. In the event that the dry basin is being cultivated, the design is such that the accumulated water will be emptied from the basin within ½ to 2 days and thus prevent damage to the crop. In order to ensure that an inlet small enough to cause a temporary lake in the basin in light rains will nonetheless empty the basin within 2 days of heavy rains, a spillway is provided to carry around the barrier that water which is in excess of the volume which the inlet can handle in this period.

In operation, the silt will initially fill the irregularities on the floor of the basin. However, as a result of repeated depositions of silt, the floor of the basin will be built up. It therefore will become necessary, as the process continues, occasionally to raise the inlet end of the conduit to ensure that the inlet level is level with or slightly above the accumulated silt level which has become the floor of the dry basin.

The Patent Claim

The single method claim of the Karch patent, in indented form for ease of understanding, reads as follows:

> The method of stopping erosion by silt-containing water flowing in a gully, and causing deposition of silt therefrom, comprising:
>
> erecting a water barrier across said gully to provide a temporary retaining basin for at least some of said water, said barrier comprising a conduit positioned substantially horizontally beneath and transversely of said barrier, the inlet of said conduit being at the lowest point in the basin;
> providing a spillway near one end of said barrier of lower elevation than the top of said barrier;
> receiving silt-containing water in said basin; causing water to collect in said basin by discharging water from the floor of said basin solely through said conduit at a flow volume substantially less than that at which water enters said basin, and thereby causing deposition of silt from said water on the floor of said basin, in substantially successive increments at the ever-changing water periphery; and
> continuously discharging desilted water from said conduit until said basin is empty;
>
> whereby erosion in said gully is eliminated and said basin is thereafter operable as a safely cultivatable dry basin, wherein the basin floor slopes upwardly from the conduit level to the ultimate silt level.

Scope of the Claim

Defendant has contended that major flood control projects built by the Government since the 1920's[4] anticipate the Karch claim and thus render it invalid for lack of novelty pursuant to 35 U.S.C. § 102. Such projects were primarily concerned with the formation of temporary lakes in rains so heavy, *i.e.*, 2, 5, 10, or 50-year storms,[5] that flood prevention measures become appropriate. The flood control

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[4] In particular, defendant points to the Miami Conservancy Project near Dayton, Ohio, and the Little Sioux Project in Woodbury and Monona Counties of Iowa.

[5] These are storms of such duration and intensity that past experience has shown that on the average they will occur respectively only once in a 2, 5, 10, or 50-year period.

structures were not intended and indeed did not result in the formation of temporary lakes in what may be termed a normal or typical rain. Rather, the flood control dams were designed to retain the high levels of water resulting from the unusual storms and thus prevent rivers from overflowing their banks and causing loss of life and property. The retained water would thereafter be discharged at a metered rate which could be conveniently and safely accommodated by the river.

Plaintiff, to the contrary, contends that methods whose utility is limited to unusual heavy rain conditions are not within the Karch method. The Karch method, plaintiff contends, is limited to the collection of silt in normal, everyday intensity rains. The large scale, heavy rains cannot be retained by the water barrier of the method in suit, but instead flow over or around the barrier by way of the spillway.

Looking to the Karch specification to determine the context in which the claims are to be read, one finds:

> This conduit is so designed that the rate of flow through it is substantially less than the normal rate of flow of water into the basin.
> * * *
> * * * Thus, if the conduit has been made too large, any simple, conventional arrangement can be made to reduce the area of the inlet opening, so that normal rainfalls will result in the formation of a temporary lake in the dry basin.

As explained by the patent specification, in heavy rains, Karch's spillway carries silt-containing water around the structure and thus the Karch method is ineffective to collect silt from a large proportion of the water that reaches the barrier in heavy rains.

Looking to the specification of a patent to determine the metes and bounds of a claim is a longstanding practice which is resorted to by all courts, including the Supreme Court, which in *Motion Picture Patents Co.* v. *Universal Film Mfg. Co.*, 243 U.S. 502, 510 (1917), noted that "[t]he scope of every patent is limited to the invention described in the claims contained in it, read in light of the specification." The Supreme Court recently restated and

reemphasized this principle in *United States* v. *Adams*, 383 U.S. 39, 49, 148 USPQ 479, 482 (1966), where it stated: "[I]t is fundamental that claims are to be construed in the light of the specification and both are to be read with a view of ascertaining the invention." It is, accordingly, concluded that the Karch method is limited to methods which function in normal rains, and excludes those methods which function only in heavy rain or flood situations.

Defendant's 35 U.S.C. § 102 Defenses

Reading the Karch method, as we must, to be ineffective in heavy rain situations, emasculates defendant's 35 U.S.C. § 102 arguments. Specifically, each of the flood control projects relied upon, *i.e.*, the Little Sioux Project in Iowa, the Germantown and Huffman Dams in the Miami Conservancy District, Farmers' Bulletin No. 1234, published by the U.S. Department of Agriculture, and, as well, the soil-saving dry dam on the Rollene Farm in Iowa, fail to disclose each and every step of the claimed invention or obtain the same result as the Karch method.

While in unusual and heavy rain situations some silt may be collected behind these dams, the collection at best occurs only rarely and most often only after a 2, 5, 10, or 50-year storm. The above projects were undeniably not intended to collect silt and operate in the manner proposed by the Karch method for the normal everyday rains. In fact, the openings or conduits used to carry the pooled water under the barriers of these flood control projects are of such dimensions that a temporary pond or pool cannot occur except in unusual 2, 5, 10, or 50-year storms.

While it is true that the builders of the dams and flood control projects realized that silt would be collected in cloud-bursting-type rains, the collection of silt was not desired or intended and was only an accidental by-product of their immediate goal of flood control. To the contrary, Karch intended his method to be effective to desilt water that drains into a gully from an average or typical everyday rain.

It must, accordingly, be concluded that the incidental and occasional collection of silt by the flood control projects

cited by defendant do not operate in the manner required of the claim in suit, and thus do not anticipate within the meaning of 35 U.S.C. § 102(a).

Defendant's 35 U.S.C. § 103 Defense

In addition to its position that the Karch patent is anticipated by certain prior art and thus invalid for lack of novelty, defendant also argues that the patent is obvious in view of the prior art and thus invalid and unenforceable.

In evaluating validity under 35 U.S.C. § 103, it is necessary to consider the following three factors:

(1) the scope of the prior art;

(2) the differences between the prior art and the claims in issue; and

(3) the level of ordinary skill in the art.

Further secondary considerations, such as commercial success, satisfying a long-felt need, or the failure of others, reflect upon the determination of obviousness under 35 U.S.C. § 103. *Graham* v. *John Deere Co.*, 383 U.S. 1, 148 USPQ 459 (1966).

It is, of course, essential in evaluating an invention against the standards of 35 U.S.C. § 103 that hindsight and the disclosure of the patent in suit not be resorted to. *See Jamesbury Corp.* v. *United States*, 207 Ct.Cl. 516, 542, 518 F.2d 1384, 1398 (1975). Adherence to that principle is assured in this instance since all the steps of the Karch method, or the motivation for a person skilled in the art to supply the missing steps, are present in the prior art.

After reviewing the differences between the prior art and the claim, the level of ordinary skill in this art, and the scope of the prior art, and after noting that such secondary considerations as are present here are insufficient to outweigh these factors, it becomes clear that the Karch patent is invalid under 35 U.S.C. § 103.

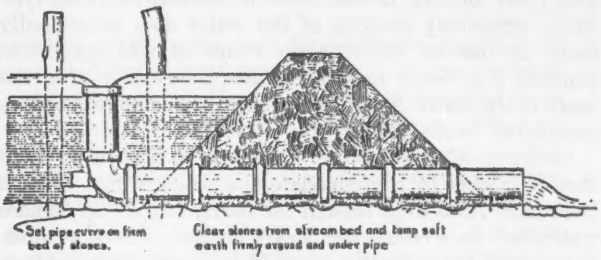
Scope of the Prior Art

As explained by the Farm Division of the Miami Conservancy District, in The Beneficial Effect of Backwater Overflow, Farm Circular No. 2 (1919), the improved

fertility of farm fields resulting from the presence of silt deposited in times of flood has long been recognized. In addition to the recognition by the art of the benefits of silt, the desirability and the feasibility of collecting it on farm fields has also been a long-standing practice as explained by the following publications: The Beneficial Effect of Backwater Overflow, *supra;* Texarkana Pipe Co., Vitrified Clay Sewer Pipe and Drain Tile on the Farm (circa 1920); U.S. Department of Agriculture, Farmers' Bulletin No. 1234 (1923); R.H. Sparks, United States Patent No. 1,083,148 (1913); and U.S. Department of Agriculture, Farmers' Bulletin No. 1669 (1931).

Further, the following publications show the recognition by the art of collecting silt to fill erosion gullies in fields: Farmers' Bulletin No. 1234, *supra;* and Vitrified Clay Sewer Pipe and Drain Tile on the Farm, *supra.* Farmers' Bulletin No. 1669, *supra,* also teaches the value of retaining silt on farm terraces.

Structures for collecting silt are shown in both Vitrified Clay Sewer Pipe and Drain Tile on the Farm, *supra,* at 2 and 7–9, and in Farmers' Bulletin No. 1234, *supra,* at 23. In each of these structures an earthen barrier is placed across the gully or depression to be filled with sediment. Silt-containing water flows down the gully and is collected behind the barrier. A layer of silt is left behind as the collected water soaks into the soil and previously-collected sediment. A drop inlet which is about 2 or 3 feet below the top of the dam functions as an emergency spillway to limit the height of the water. When the height of the water in the basin exceeds the height of the drop inlet, the excess flows into the drop inlet and is carried through a horizontal sewer pipe that extends beneath and transversely of the earthen barrier substantially as shown hereinbelow:



Lengthwise section of gulley showing cross section of earth dam and installation of vitrified clay sewer pipe underflow.

Further, the Vitrified Clay Sewer Pipe and Drain Tile on the Farm article, *supra*, at 11, teaches that in some climates and under certain conditions of soil, the basin behind the dam will be too wet to cultivate. It thus becomes necessary to remove the water trapped in the basin more quickly. The article suggests placing a line of drain tile below the earth to collect and remove the water from the saturated soil.

Also part of the prior art is the previously-mentioned structure built by the Soil Conservation Service on the Rollene farm, Franklin County, Iowa, in 1950 for the purpose of stopping the advance of an erosion gully. The Rollene farm illustrates another method for removing the water from behind an earthen barrier. The structure consists of an earthen barrier across a gully with a 12" tile drain passing beneath it. The tile is supplied by an 18" drop inlet located at the lowest point of a basin. An auxiliary spillway to carry off excessive amounts of water and thus prevent damage to the barrier is also provided near one of its ends. It appears that the Rollene structure successfully eliminated erosion in the gully by slowing the water that flows in the gully from an 85-acre watershed. Due to the successful operation of the barrier, grass is now growing in the gully downstream of the barrier, and the

upstream basin has not been washed away even in very hard rains.

Even though the 18" drop inlet is too large to enable a pool from forming in the basin in normal everyday-type rains, temporary ponding of the water does occasionally occur in heavier rains. As a result of this occasional ponding, 3 to 6-acre feet of silt have been collected in the basin in the period from 1950 to 1975. This amount of silt is considered negligible for this structure.

As previously mentioned, the 18" drop inlet is so large that it is able to accommodate the water which collects from most rains even though the barrier serves an 85-acre watershed. As a result, temporary ponding occurs, at most, only two or three times a year. The normal everyday-type rains are removed from the basin so quickly that silt is not given time to deposit. In order to cause a temporary pond which takes 12 hours to drain, for example, it is necessary to have a rain of a 10-year intensity on the Rollene farm.

The Differences Between the Prior Art and the Claim

In the main, the method illustrated by Vitrified Clay Sewer Pipe and Drain Tile on the Farm, *supra*, differs from the Karch method only in the rate and structure by which the water is removed from the basin. This prior art method appears to rely upon water soaking into the soil to remove the water. The soaking process may require a long period of time to complete and the ground in the meantime may become soggy. This prior art reference also does not show an inlet into the tile conduit at the lowest point of the basin or a spillway near one end of the barrier.

On the other hand, the Rollene structure contains most of the ingredients required by the Karch method, including an inlet into the tile conduit at the lowest point of the basin and a spillway near one end of a barrier at a lower elevation than the top of the barrier. As a result, the water flowing into the basin passes, by way of the inlet, into the horizontal conduit below the barrier. However, the Rollene method is designed for heavy rains, and since the ratio of the inlet size to the watershed it services is much larger than in the Karch method, the method does not collect silt

in the normal rain situation as required by the Karch claim.

Level of Ordinary Skill

A review of the prior art demonstrates that one of ordinary skill in this art fully appreciates the properties of silt and the beneficial effect of having silt deposited upon his fields. As pointed out in The Beneficial Effect of Backwater Overflow on Agricultural Lands, *supra*, silt has long been recognized as a worthwhile fertilizer. The pamphlet states that lands subject to periodic submergence are generally the richest. Further, it points out that such lands maintain their great fertility without crop rotation or application of manure or other fertilizers. Indeed, fields subject to the deposition of silt are often more productive than fields to which manure and other fertilizers are artifically applied. Accordingly, one of ordinary skill in the farming arts wishing to use his fields to produce crops would obviously encourage the deposition of silt on his fields.

The documents of record also convincingly demonstrate that the prior art recognized that the amount of silt which can be carried by water is proportional to its speed. Thus, as the speed of flowing water increases silt is picked up and as the speed decreases silt is deposited. Silt is deposited most thoroughly and quickly from water which has been temporarily retained in a standing pool as in the example discussed and illustrated in the Vitrified Clay Sewer Pipe and Drain Tile on the Farm pamphlet, *supra*.

Moreover, it was equally well known that water standing on crops for too long a period will damage the crops. A trade-off between the desire of having the water stand in the basin for a long period of time in order to recover as much of the silt as possible on the one hand, and, on the other hand, the desire of removing the water from planted fields to avoid crop damage would obviously be recognized by a person of ordinary skill in the art.

Thus, if in using the Vitrified Clay Sewer Pipe and Drain Tile on the Farm, *supra*, method and structure for the desilting of rainwater it turned out that the land was too

soggy for cultivation, it is obvious that ways for draining the water off the land more quickly would be resorted to. One way, the way suggested by the Rollene farm, is to provide an inlet to the tile buried beneath the barrier at the lowest point of the basin. Further, keeping in mind the desired goal of achieving maximum desilting without crop damage, one of ordinary skill would obviously make the drop inlet small enough to cause temporary ponding and desilting for normal rains, but large enough to remove the water before crop damage set in.

Thus, one of ordinary skill in the farming arts following the suggestions of Vitrified Clay Sewer Pipe and Drain Tile on the Farm, *supra*, for cultivating the land covered by silt deposited behind a soil-saving dam, would find it obvious to place an inlet to the tile system at the lowest point of the basin as taught by the Rollene structure to dispell a boggy condition. Further, such person would make the inlet small enough to cause the formation of a temporary pool to maximize the desilting operation, but not so small that the water would be retained so long that damage to the crops occurs. Accordingly, all of the steps called for by the Karch method would have been obvious, within the meaning of 35 U.S.C. § 103, to a person of ordinary skill in the art.[6]

CONCLUSION

Based on the above analysis, it must be concluded that claim 1, the only claim of the Karch patent, is invalid and

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[6] Plaintiff stresses a number of alleged secondary considerations (commercial success in central Illinois where plaintiff lives; past failures of others; contemporaneous reactions of experts; purported satisfaction of a long-felt need of farmers) but, here as in *Graham* v. *John Deere Co.*, *supra*, 383 U.S. at 36, "these factors do not, in the circumstances of this case, tip the scales of patentability." It is settled that where obviousness is clear (as in the present case), such secondary considerations cannot turn invalidity into validity. *Anderson's-Black Rock, Inc.* v. *Pavement Salvage Co.*, 396 U.S. 57, 61 (1969); *Sakraida* v. *Ag Pro, Inc.*, 425 U.S. 273, 282–83 (1976). Moreover, just as in *Graham* v. *John Deere Co.*, *supra*, the favorable reception of plaintiff's alleged invention may have been due to the fact that the enthusiasts were not adequately aware of the knowledge stored in the Patent Office and other repositories of the prior art. Nor has plaintiff proved that such success as he obtained was due to his particular claimed contribution, not to other factors. *See Bourns, Inc.* v. *United States*, 210 Ct. Cl. 642, 658–59, 537 F.2d 486, 495 (1976); *Jacobson Bros.* v. *United States*, 206 Ct. Cl. 518, 531–32, 512 F.2d 1065, 1072–73 (1975). [footnote by the court]

Syllabus

unenforceable. The issue of infringement need not be addressed. Plaintiff is not entitled to recover, and his petition is dismissed.

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568 F.2d 729

AEROJET-GENERAL CORPORATION v. THE UNITED STATES

[No. 332–72. Decided December 14, 1977]

ON THE PROOFS

Contracts; cost principles; military procurement; independent research and development costs; cost-sharing; legislative history of Pub. L. 91–441.—During fiscal year ended November 30, 1971, a subsidiary of plaintiff, in performing cost-type military procurement contracts, incurred reasonable independent research and development (IR&D) costs potentially related to a military function and properly allocable to Department of Defense contracts. The contracting officer, believing that as a stimulus to efficiency, a contractor could lawfully be required to share a portion of otherwise recoverable IR&D costs, was agreeable to reimbursement of only $950,000 of the $1,084,438.57 costs. Upon rejection by plaintiff of the offer of partial reimbursement, the contracting officer, in conformity with stated DOD policy, limited reimbursement to a lesser sum. After an unsuccessful appeal of the contracting officer's action, plaintiff filed the present suit for the unreimbursed balance of its subsidiary's IR&D costs. The issue before the court is the propriety under Sec. 203 of Pub. L. 91–441, 84 Stat. 906, of the unilateral imposition by the Government of such a cost-sharing arrangement upon the contractor, against the latter's will. The court points out that the contracting officer did not ask plaintiff to restrict its IR&D to $950,000 but was willing for more to be spent so long as the Government would be responsible only for its pro rata share of that sum. After an extensive review of the legislative history of Pub. L. 91–441, it is *concluded* that said history convincingly demonstrates that the principle of cost-sharing was not intended to play any part in ascertainment of the dollar ceilings to be negotiated for purposes of mandatory advance agreements limiting contractor reimbursements for IR&D costs. No one in Congress affirmatively endorsed cost-sharing as an appropriate or desirable instrument for control. The court emphasizes that the validity of a cost-sharing undertaking is not questioned where that is voluntarily agreed upon by the contractor and the Government. It is *held* that plaintiff is entitled to recover, and, since the parties have agreed that, on the basis the case is decided, the amount of

the judgment should be $368,963.16, judgment for plaintiff is entered in that amount.

Contracts; cost principles; military procurement; independent research and development costs; cost-sharing.

[1] When considered as an original proposition, and absent a cost-sharing undertaking voluntarily agreed upon by a contractor and the Government, a contracting officer's insistence that a contractor could legally be required to share a portion of otherwise recoverable independent research and development costs respecting military procurement as a stimulus to efficiency in performance, is unwarranted by the direct language and intent of Sec. 203 of Pub. L. 91–441 in light of its legislative history.

United States ⚖73(9)

Statutes; construction and operation; judicial interpretation.

[2] It is not the function of a court to engraft on a statute additions which it thinks the legislature might or should have made.

United States ⚖70(21)

Alan V. Washburn, attorney of record, for plaintiff. *J.C. Andreason*, of counsel.

Frances L. Nunn, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant. *Jon Van Horne*, of counsel.

Before DAVIS, KUNZIG, and BENNETT, *Judges*.

PER CURIAM: In this case involving the reimbursability of independent research and development costs (IR&D), and the impact of section 203 of Pub. L. No. 91–441, 84 Stat. 906 (Oct. 7, 1970), Trial Judge Willi has determined that plaintiff is entitled to prevail. Both parties have filed exceptions, but the plaintiff is satisfied with the end-result, seeking merely some changes in the trial judge's opinion and findings. The court has considered the oral argument as well as the briefs and exceptions. The conclusion is that we agree with the trial judge's opinion (which is set forth *infra*), as supplemented and modified by the following paragraphs.*

We emphasize that we do not understand the trial judge's opinion as questioning the validity of a cost-sharing

* The court also adopts the trial judge's findings but they are not printed since the necessary facts are stated in this *per curiam* opinion, including the trial judge's opinion.

undertaking where that is voluntarily agreed upon by the contractor and the Government. The case involves only the propriety under § 203 of Pub. L. No. 91–441 of the unilateral imposition by the Government of such a cost-sharing arrangement upon the contractor, against the latter's will. There is no intimation in our holding that the contractor and the procurement agency are forbidden to adopt such an arrangement if they both wish to do so.

We also add to the trial judge's opinion some discussion of the defendant's contention, stressed at oral argument, that the $950,000 figure chosen by the contracting officer represented a reasonable specific dollar ceiling for IR&D—a specific ceiling permissible under § 203 of Pub. L. 91–441. Plaintiff says that no specific dollar ceiling is ever allowable under the statute—even if the Government wishes for good cause to control research and development by establishing a top limit on such expenditures by its contractor—but we need not reach or decide that question. The reason is that it is clear that, in this instance, the contracting officer did not attempt to set the $950,000 as a true ceiling limiting plaintiff's total expenditures for independent research and development. The findings are plain that the $950,000 figure represented solely the contracting officer's attempt to make plaintiff bear by itself all costs over that amount, *i.e.* an attempt to impose cost sharing upon the plaintiff. He did not ask plaintiff to restrict its IR&D to $950,000, but was quite willing for more to be spent so long as the Government would be responsible only for its pro rata share of that sum. The contracting officer insisted on such cost-sharing because he believed that it was a good prod to increased efficiency, not because he thought $950,000 was enough for plaintiff to spend on the IR&D involved here.

For the reasons given by the trial judge together with those stated above, we hold that plaintiff is entitled to recover. The parties have agreed that, on the basis we decide the case, the amount of the judgment should be $368,963.16. We enter judgment for plaintiff in that amount.

OPINION OF TRIAL JUDGE

WILLI, *Trial Judge:* Plaintiff is a large defense contractor comprised of several operating divisions, one of which is Aerojet ElectroSystems Company (AESC). In the fiscal year ended November 30, 1971, AESC was performing a number of cost-type military procurement contracts. During that period it incurred independent research and development (IR&D) costs totaling $1,084,438.57 for which it sought reimbursement under the procurement contracts as indirect expenses allocable thereto. It has been agreed for purposes of this litigation that those costs were reasonable in amount, were for projects that had a potential relationship to a military function or operation, and were properly allocable to Department of Defense (DOD) contracts (as opposed to AESC contracts with others). In these circumstances defendant's contracting officer, believing that as a stimulus to efficiency a contractor could lawfully be required to absorb a portion of otherwise recoverable IR&D costs, was agreeable to reimbursement of only $950,000 of the $1,084,438.57. When AESC rejected that offer of partial reimbursement the contracting officer, acting in conformity with stated DOD policy, limited AESC's reimbursement to $712,500 (75 percent of $950,000). After completing an unsuccessful administrative appeal of the contracting officer's action, plaintiff brought the present suit for the unreimbursed balance of AESC's IR&D costs for the fiscal year ended November 30, 1971.

To the extent that the trial on which defendant insisted produced facts beyond those evident from the pleadings, they proved to be of only background significance. Subsequent briefing found the plaintiff urging at great length a varied assortment of legal contentions of a largely superfluous nature. None of this welter of activity has changed the question for decision from that clearly posited by the pleadings; whether section 203 of Pub. L. No. 91–441, 84 Stat. 906,[1] authorizes the Secretary of Defense to

[1] The statutory language, enacted October 7, 1970, is as follows:

"SEC. 203. (a) Funds authorized for appropriation to the Department of Defense under the provisions of this or any other Act shall not be available after December 31, 1970, for payment of independent research and development or bid and proposal costs unless the work for which payment is made has, in the opinion of the Secretary

condition his approval of the amount of IR&D costs for which a contractor may be reimbursed, on the latter's willingness to absorb a portion of those costs that is admittedly otherwise reimbursable. For the reasons that follow, it must be concluded that however meritorious such

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of Defense, a potential relationship to a military function or operation and unless the following conditions are met—

"(1) the Secretary of Defense, prior to or during each fiscal year, negotiates advance agreements establishing a dollar ceiling on such costs with all companies which during their last preceding fiscal year received more than $2,000,000 of independent research and development or bid and proposal payments from the Department of Defense, the advance agreements thus negotiated (A) to cover the first fiscal year of each such contractor beginning on or after the beginning of each fiscal year of the Federal Government, and (B) to be concluded either directly with each such company or with those product divisions of each such company which contract directly with the Department of Defense and themselves received more than $250,000 of such payments during their company's last preceding fiscal year;

"(2) the independent research and development portions of the advance agreements thus negotiated are based on company submitted plans on each of which a technical evaluation is performed by the Department of Defense prior to or during the fiscal year covered by such advance agreement; and

"(3) no payments for independent research and development or bid and proposal costs are made by the Department of Defense to any company or product division with which an advance agreement is required by subsection (a)(1) of this section, except pursuant to the terms of that agreement.

"(b) In the event negotiations are held with any company or product division with which they are required under subsection (a)(1) of this section, but no agreement is reached with any such company or product division, no payments for independent research and development or bid and proposal costs shall be made to any such company or product division during the fiscal year for which agreement was not reached, except in an amount substantially less than the amount which, in the opinion of the Department of Defense, such company or product division would otherwise have been entitled to receive, subject to appeal by such company or product division under regulations to be prescribed by the Secretary of Defense.

"(c) The Secretary of Defense shall submit an annual report to the Congress on or before March 15, 1971, and on or before March 15 of each succeeding year, setting forth—

"(1) those companies with which negotiations were held pursuant to subsection (a)(1) of this section prior to or during the preceding fiscal year of the Federal Government, together with the results of those negotiations;

"(2) the latest available Defense Contract Audit Agency statistics, estimated to the extent necessary, on the independent research and development or bid and proposal payments made to major defense contractors, whether or not covered by subsection (a)(1) of this section during the preceding calendar year; and

"(3) the manner of his compliance with the provisions of this section, and any major policy changes proposed to be made by the Department of Defense in the administration of its contractors' independent research and development and bid and proposal programs.

"(d) The provisions of this section shall apply only to contracts for which the submission and certification of cost or pricing data are required in accordance with section 2306(f) of title 10, United States Code.

"(e) Section 403 of Public Law 91-121 (83 Stat. 204) is hereby repealed."

a grant might have been as a matter of policy, Congress conferred no such authority.

IR&D costs are those costs incurred by a contractor, in this instance AESC, for research and development *not* directly sponsored by a contract, grant or other arrangement. Such costs are therefore not recovered by the contractor nor budgeted by DOD in the same way as similar-type costs pertaining to the performance of an R&D contract. Instead, the funds that are used to reimburse IR&D costs are typically drawn from DOD appropriations for procurement of military hardware. These costs are reimbursed from that source as a part of the indirect expense of the contractor's performance of such procurement contracts.

Closely related to IR&D costs are so-called bid and proposal (B&P) costs. By definition, those are costs incurred for preparing bids or proposals on potential government and non-government contracts or projects, including the development of both cost and engineering data necessary to support such bids and proposals. From the standpoint of funding by the Government and recovery by the contractor, the comments already made in respect to IR&D costs apply equally to B&P costs.

Prior to 1960 IR&D costs were generally not recoverable at all under cost-type military procurement contracts. Between 1960 and 1970 recovery thereunder was governed solely by provisions of the Armed Services Procurement Regulations (ASPR). ASPR § 15.205–35 [32 C.F.R. § 15.205–35 (1970)], provides that IR&D costs are recoverable to the extent that they are (1) reasonable in amount, (2) are related to product lines for which the Government has contracts, and (3) are allocated to all of the contractor's work on such product lines. Finding 4. In hortatory terms, the same regulation advances two proposals that are pertinent for present purposes; first, that where the work of the contractor involved is predominantly with the Government an advance agreement, as described in ASPR § 15.107, is particularly desirable; and second, that "In recognition that cost sharing of the contractor's independent research and development program may provide motivation for more efficient accomplishment of such

program, it is desirable in some cases that the Government bear less than an allocable share of the total cost of the program." Finding 4. In turn, ASPR § 15.107 counsels the desirability of the contractor and the Government entering into an agreement as to the allowability of IR&D costs (among many others) in advance of their incurrence "* * * in order to avoid possible subsequent disallowance or dispute based on unreasonableness of non-allocability * * *." The same regulation explicitly states, however, that the absence of an advance agreement as to any element of cost will not, in itself, serve to make that element either allowable or unallowable. Finding 4. The incorporation of the latter principle in ASPR reflects acceptance of a 1967 holding to that effect by the Armed Services Board of Contract Appeals in *Technical Communications Corp.*, 67–2 BCA ¶ 6525.

The first piece of legislation relating to the subject of Government reimbursement of IR&D costs was contained in section 403 of Pub. L. No. 91–121, 83 Stat. 207, a general military appropriations bill for the fiscal year 1970. That legislation, which was the immediate forerunner of Pub. L. No. 91–441, *supra*, originated as S. 2546, 91st Cong., 1st Sess. As introduced and as reported to the Senate by its Armed Services Committee, the Bill contained nothing pertaining to IR&D costs. In the course of floor consideration Senator Proxmire offered an amendment to the Bill, adding the following provision (115 CONG. REC., Part 19, at 25597):

> SEC. 402. Funds authorized for appropriation under the provisions of this Act shall not be available for payment of independent research and development, bid and proposal, and other technical effort costs in a total amount in excess of $468,000,000. The foregoing limitation shall not apply in the case of formally advertised contracts or to other firmly fixed price contracts compet[-it]ively awarded.

The Senator, who was to be the author and principal spokesman in support of this and follow-up legislation imposing Congressional surveillance and control of Government reimbursement for IR&D costs, explained the pur-

pose and need for his amendment as follows (115 CONG. REC., Part 19, at 25598–600):

> MR. PROXMIRE. Mr. President, the Department of Defense spends billions of dollars each year on research and development contracts. Many persons have questioned the high level of military spending in this area, and the Armed Services Committee made a significant reduction in the funds authorized this year, a reduction which I certainly applaud and support.
>
> There is another, lesser known R. & D. program, however, distinct from the multibillion-dollar contract program which goes by the name of Independent R. & D. It is an apt title for this program, for the contractors who receive I.R. & D. funds are free to spend them independent of any contracts they may have with the Government, and independent of almost all Government controls.
>
> *Last year $685 million was spent by the Department of Defense for I.R. & D. In view of the fact that no contractual controls were exercised over these public funds, and very little administrative controls of any kind, very serious questions need to be raised about the management of this program.*
>
> But in view of the fact that the Pentagon is already spending billions of dollars on its R. & D. contracts, an even more serious question must be asked: What is the justification for this program? *How do we justify spending about $8 billion a year on military R. & D. contracts, and another $685 million on non-contracted Independent R. & D.?* Does this not represent duplication of effort of the most extreme kind?
>
> Independent R. & D. represents one of the most serious and little known problems in Government procurement. *It is a disturbing fact that the Department of Defense exercises little or no control over the amount of public money paid to contractors for Independent R. & D. and related expenses.* What is even more disturbing is the fact that Department of Defense is now planning to completely eliminate the little control it now exercises and instead to substitute a formula to pay such costs.
>
> In order to fully understand the magnitude of the problem, a full explanation of independent research and development and its related costs is necessary.
>
> Let me point out first of all that Independent R. & D. is not the same as research and development. It is essential that the two programs be clearly distinguished. In contrast to federally contracted research and development, I.R. & D. is not sponsored, or administered directly

by the Government. Under an I.R. & D. program, as distinguished from a Government contracted R. & D. program, the contractor is free to decide whether to perform I.R. & D. in the area of military products or commercial items. Under I.R. & D. programs, the initiation, control, and direction of I.R. & D. projects rests with the independent contractor, not the Government, as under normal R. & D. *[O]f crucial importance under an I.R. & D. program is the fact that the work done does not have to be directed toward the completion of government contract work. It can be totally unrelated to government business.*

Closely related to I.R. & D. are two other technical cost items normally considered with I.R. & D. The first of these are bidding and proposal expenses. These costs result from the technical effort involved in preparing bids and proposals for Government contract work. These costs are always underwritten 100 percent by the Government. The significance of this fact will become clear shortly. The second related area of technical expense is known as Other Technical Effort—OTE. Despite repeated efforts, I have been unable to obtain a clear and satisfactory definition of this category of expense from the Pentagon. No one seems to be able to precisely define the nature or purposes of this expense item. The Government Accounting Office, in an extensive study released last July, suggests that other technical effort should be considered along with independent research and development since "it appears that a substantial portion of this amount involves technical effort similar to I.R. & D." Like bidding and proposal expenses, other technical effort expenses are always underwritten 100 percent by the Government.

Essential to an understanding of independent research and development and these two related areas of technical costs is the fact that the Government does not contract for the work. *In effect, the Government is presented a bill for services rendered which it never specifically requested.* The usual justification for this astonishing practice is that I.R. & D. provides the broad technical capability needed by a company to meet future Government contract needs. Exactly what capabilities are being developed has never been clear. The term "technical capability" is so broad and so vague that literally anything has been accepted. Current armed services procurement regulations state:

"An I.R. & D. project, to be acceptable, must be related to the product lines for which the government has contracts."

The interpretation of the term "product lines" has been unclear since the publication of the armed services procurement regulations. [Emphasis added.]

* * * * *

* * * *The expenditure of I.R. & D. moneys is going for research activities totally unrelated to military needs.* Defense contractors are encouraged to use DOD funds to expand their commercial business and on projects designed to assist in the solution of our domestic problems. Mr. President, if we need better housing, why should not the money be given to the Department of Housing and Urban Development which specializes in this area? Does it make sense to use our military program to support nonmilitary projects in order to justify an outmoded form of expenditure known as independent research and development? If the Government really needs increased research into our domestic problems, let us give the money to those who are best equipped to spend it—those people who are specialists in the field who can give the taxpayer the most for his research dollar.

The almost total lack of control over independent R. & D. by the Government is dramatically shown by a review of recent expenditures for this work. *A recent DOD audit covering 94 of the Department's major contractors shows that from a total of $459 million in 1963, I.R. & D. and related costs have skyrocketed to $685 million in 1968.* Although sales by the contractors to DOD have increased by only 28 percent between 1963 and 1968—$17,916,000,000 to $22,875,000,000—for those covered by the study, the amount of combined I.R. & D. and related costs reimbursed by the Government to these same contractors has increased by 49.2 percent—$459,000,000 to $685,000,000—a percentage increase almost double the percentage increase in sales to DO[D]. The problem has become especially acute in the past year. Although contractor sales to DOD increased by only 7.4 percent between 1967 and 1968, the amount of I.R. & D. and related costs reimbursed by the Government for the same period increased by 14.3 percent, a percentage increase almost twice the percentage increase in Government contract work. All of this in spite of the fact that the Government is already spending over $8 billion a year for regularly contracted research and development.

What this amounts to is that the public is being asked to support uncontrolled spending.

Contrary to the practices of the Atomic Energy Commission, the Pentagon does not know how much it will pay and does not control the amount it will pay for independent R. & D. *On occasion, advanced agreements with contractors are made by the service branches for future I.R. & D. in defense work. But this is the exception, not the rule.* The Government does not normally know even the programs for which it will end up paying the costs. In other words, the Department of Defense often does not even know what kind of programs or even the areas in which independent R. & D. money will be applied by the contractors. [Emphasis added.]

* * * * *

As I mentioned earlier, some contractors enter into advance agreements with the Government with respect to the projects for which I.R. & D. funds will be spent over the following year. *If we are to have an I.R. & D. program at all, advance agreements certainly give to the Government a degree of control over it that it does not presently have. Advance agreements at least give the Government an opportunity to decide whether proposed expenditures by a private contractor will in any way benefit the Government.*

However, contractors have resisted even this modicum of government control. Many contractors have been unwilling to negotiate advance agreements. And in a case decided by the Armed Services Board of Contract Appeals on August 8, 1967—ASBCA No. 11931—it was ruled that where an advance agreement is not reached between the contractor and the Government, the Defense Department is still authorized to allow 100 percent of the contractor's I.R. & D. costs. Under the present policy, therefore, the contractor actually has an incentive not to enter into advance agreements.

Even if advance agreements were entered into in every case, however, the major question surrounding the I.R. & D. program would not be answered. Why do we need to spend $685 million for an I.R. & D. program when we are already spending billions of dollars on R. & D. contracts?

I believe this question needs to be asked and answered. From the study I have made, I can frankly see no justification for this program. If there is any justification for it, that fact needs to be demonstrated.

But even if the program is justified, it is not justified in its current, uncontrolled condition.

I have felt for a long time that this program should not only be questioned but deleted, but I have discussed this issue with the distinguished Senator from New Hamp-

shire (MR. MCINTYRE), who is the expert on the Armed Services Committee on R. & D. work, and with the distinguished chairman of the committee. *I have concluded, in view of the fact that this is an extraordinarily complicated area and there are very sincere and able people who contend that the program should continue, that a compromise would be more logical. For that reason I have agreed to an amendment which places a ceiling on I.R. & D. funds authorized to be spent in the current fiscal year in the amount of $468 million.*

This will reduce the amount by about $117 million below what it otherwise would be.

In addition, I intend to introduce further proposed legislation on this matter, and I have been informed that the Committee on Armed Services will hold hearings on it next year, and have been told that if I did this, I would be invited to appear as a witness for that bill.

Mr. President, I reserve the remainder of my time.

MR. STENNIS. Mr. President, I think this is an important matter. It involves an item in the bill for a special kind of research that has been described by the Senator from Wisconsin. The sum for this year was $585 million. Last year it was $685 million. It varies according to the number of contracts we have, especially for weaponry.

In this connection, I do not like that word "compromise" too much; I simply could not agree to the Senator's original amendment, far reaching as it is, being adopted without hearings. So we agreed that the Senator would introduce the main part of his amendment as a bill, and the Committee on Armed Services would give full hearings on it, because it is something that ought to be developed with a better formula, a better understanding, and a better rationale. I do think, however, that there is great merit in some of this research.

We talked about reducing it somewhat this year, and we agreed on a 20-percent reduction, as the Senator stated; and his amendment, modified to carry that point only, will be supported by the members of the committee who have had a chance to look at it including the chairman.

Mr. President, I wish to yield some time to the Senator from New Hampshire, who has held some very important hearings for us on the subject of research and development. I shall yield to the Senator from California (MR. CRANSTON), later. I now yield 5 minutes to the Senator from New Hampshire.

MR. MCINTYRE. Mr. President, I believe our colleague from Wisconsin has done the Senate a service in

bringing up this amendment. It directs itself at business practices which are not well understood and yet are of a critical nature to the DOD overall mission. We need to understand these activities.

These are not carried as line items in the Defense Department budget but are part of the overhead costs of DOD contractors. This means that they are treated as part of the normal administrative costs of running a business, just like the contractor's accounting department or the salary of the company president. It is estimated that these expenditures are now running in the neighborhood of some $600 million a year.

As the chairman of the committee, the Senator from Mississippi (Mr. STENNIS), has stated, no hearings have been held in the Senate directly related to this subject.

I am not suggesting, Mr. President, that because we have not had the chance to look at this in detail means that these activities are running slip-shod or out of hand. I think the record will show that they have been well managed to date and have made an enormous contribution to the Defense effort. This does not mean that their management cannot be improved—indeed the DOD jointly with NASA are currently working on an improvement in these areas.

I.R. & D. is that research and development function of Department of Defense contractors which is not directly tied to a specific contract, grant or other item of the budget or precise function of the Department, but consists of projects undertaken independently by contractors to increase their technical knowledge and capability and to develop products for future sales. The purpose of the I.R. & D. effort is to assure the continuation and growth of the company by improving the contractor's technical competitive position and giving him new products and technology of value to the Department of Defense.

So, with the concurrence of the Senator from Mississippi, *we have not only agreed with the Senator from Wisconsin* (MR. PROXMIRE) on this 20-percent reduction, but also, as chairman of the Subcommittee on Research and Development, I have assured the Senator from Wisconsin that we will commence hearings on his amendment, which, as I understand, will be introduced as a bill, before the end of this year; and next year when we come back, we will all have a better grasp of it and can work more intelligently on it. [Emphasis added.]

* * * * *

The foregoing remarks reflect the following as the essentials of Senator Proxmire's position on IR&D in 1969:

1. That there was a serious question as to the justification for expending any military appropriations at all to subsidize IR&D in a year when some $8,000,000,000 was provided for contractually defined R&D work.
2. That from 1963 to 1968 DOD reimbursements for IR&D had risen from $459,000,000 to $685,000,000, a percentage increase almost double that of the increase in DOD purchases of military hardware over the same period.
3. That DOD was not exercising control over either the total amount of money that it was disbursing to reimburse contractor's IR&D costs or over the nature of the work for which those costs were being incurred.
4. That the overall subject of IR&D and related activities was little understood by the Congress and was therefore in urgent need of further study as a preliminary to corrective legislation of a detailed nature.
5. That in view of the Senate's commitment to examine the subject of IR&D in depth for the purpose of additional legislation to be considered in the next session of the Congress, the practical approach to the problem for purposes of the DOD's 1970 fiscal year was a simple reduction of 20 percent in the amount of money that DOD proposed to disburse for reimbursement of IR&D and related costs during that year without attempting to legislate restrictions on the amount of reimbursement that an individual contractor could receive.

It is significant for present purposes that the matter of cost sharing by contractors performing IR&D apparently formed no part of the deliberations leading to adoption of Senator Proxmire's amendment providing simply for a dollar ceiling on DOD outlays for reimbursement of IR&D costs. Specifically, the potential value of an advance agreement, in the Senator's view had nothing to do with cost sharing. He viewed it as a means of forewarning DOD of the nature of research that a contractor expected it to subsidize, thereby enabling it to refuse in advance to pay for work that was not defense oriented.

The Senate unanimously adopted Senator Proxmire's $468,000,000 ceiling-type amendment. 115 CONG. REC., Part 19, at 25601.

The House refused to accept the Proxmire amendment and the matter went to conference where it was ultimately compromised in the manner explained by the Conference Report, as follows (H. CONF. REP. No. 91–607, 115 CONG. REC., Part 24, at 32924):

SECTION 403. INDEPENDENT RESEARCH AND DEVELOPMENT

The Senate version contained a provision requiring that funds authorized by the Act shall not be available for the payment of independent research and development, bid and proposal, and other technical effort costs in the total amount in excess of $468,000,000. The provisions did not apply in the case of formally advertised contracts or to other firmly fixed price contracts competitively awarded.

This language was intended to provide a reduction of approximately 20% in the funds which would otherwise be expended for this purpose during Fiscal 1970. The House version contained no comparable language.

The conferees agreed on a compromise, which provides that contracts awarded subsequent to the effective date of this Act, costs incurred for independent research and development, bid and proposal and other technical effort shall not be in excess of 93% of the amount contemplated for such purposes in the 1970 Defense procurement and RDT&E program. This limitation shall not apply in the case of formally advertised contracts, other firmly fixed contracts competitively awarded, or contracts under $100,000. This limitation shall not apply to present contracts awarded prior to the effective date of this Act and shall not disturb independent research and development and other technical efforts already agreed upon.

It should be understood that the language of Section 403 applies to the Fiscal Year 1970 program only and is not to be considered a precedent for any future legislation. The Committee on Armed Services intends to study the matter of independent research and development and other technical effort and bid and proposal financing in detail during its review of defense authorization requests in the next session of Congress. The Senate conferees agreed with the House conferees that this matter is inadequately understood and that much greater knowledge must be gained in this area before determination is made as to any further legislative requirements.

Though not cast in terms of a specific dollar ceiling, as in the case of the Proxmire amendment, the conference version was directed to the same objective. Whereas the Proxmire amendment called for a 20-percent reduction in DOD proposed spending for IR&D, the compromise language provided for a 7 percent reduction. 115 CONG. REC., Part 25, at 33381–82. Thus, section 403 of Pub. L. No. 91–121, as enacted, provided as follows:

> * * * Funds authorized for appropriation under the provisions of this Act shall not be available for payment of independent research and development, bid and proposal, and other technical effort costs incurred under contracts entered into subsequent to the effective date of this Act for any amount in excess of 93 per centum of the total amount contemplated for use for such purposes out of funds authorized for procurement and for research, development, test, and evaluation. The foregoing limitation shall not apply in the case of (1) formally advertised contracts, (2) other firmly fixed contracts competitively awarded, or (3) contracts under $100,000.

In keeping with his previously declared intention, Senator Proxmire introduced additional legislation that was to serve as a major focal point for further evaluation of the IR&D problem during the next session of the Congress. On October 8, 1969, Senator Proxmire introduced S. 3003 (115 CONG. REC., Part 21, at 29118). It provided:

> A BILL To provide for more effective control over the expenditure of funds by the Department of Defense and the National Aeronautics and Space Administration for independent research and development, and for other purposes
>
> *Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That section 2301 of title 10, United States Code, is amended by adding at the end thereof the following:
>
> "(4) 'Agency concerned' means the Department of Defense and the military departments thereof or the National Aeronautics and Space Administration."
>
> SEC. 2. Chapter 137 of title 10, United States Code, is amended by adding at the end thereof the following new sections:
>
> "§ 2315. Research and development costs

"(a) No costs for research and development shall be allowable under any negotiated contract entered into by the agency concerned unless provision for such costs are specifically provided for in the contract; and no research and development costs shall be allowable under any such contract unless such costs provide a direct or indirect benefit to the work being performed under the contract.

"(b) Whenever funds are authorized under any negotiated contract to carry out one or more independent research and development projects, the contractors or subcontractor shall be required to submit to the agency concerned a technical appraisal of each such project. A technical appraisal submitted pursuant to this subsection shall be prepared in accordance with regulations issued by the agency concerned.

"(c) Any research and development costs determined not to be of direct or indirect benefit to the work being performed under the contract may not be allowed as an overhead expense under the contract.

"(d) As used in this section the term 'research and development' includes (1) either research or development, or both, and (2) any other work or service generally identified or classified as 'other technical effort'.

"§ 2316. Bid and proposal expenses

"The cost of preparing bids or proposals, successful or unsuccessful, shall be an allowable expense of a contractor or subcontractor under any negotiated contract if the subject matter of the bids and proposals is applicable to the program of the agency concerned. The cost of preparing bids or proposals shall be allocated only as indirect costs of the contractor or subcontractor. In no case may the amount allowed for bid and proposal expenses under any negotiated contract (1) exceed 1 per centum of the direct material (exclusive of capital equipment) and the direct labor costs of the contract performed or to be performed, or (2) include negotiating or promotional expenses, expenses properly allocable to research and development, or the expense of salesmen, representatives, or agents who do not provide technical services in connection with the bid or proposal."

SEC. 3. The table of sections at the beginning of chapter 137 of title 10, United States Code, is amended by adding at the end thereof the following:

"2315. Research and development costs.
"2316. Bid and proposal expenses."

SEC. 4. The amendments made by this Act shall be effective with respect to contracts entered into on and after the date of enactment of this Act.

Presumably the above proposal embodied all of the curbs that the Senator deemed necessary and appropriate to eliminate the waste and inefficiency that he perceived in IR&D programs as theretofore administered by DOD. Notably, for present purposes, that proposal concentrated entirely on insuring that all IR&D work to be paid for by the Government was specifically authorized in advance and clearly identified as having a subject-matter relationship to the procurement contract against which the cost of the IR&D work would be charged. In short, Senator Proxmire's concern was apparently with simply insuring that the Government receive the benefit of the IR&D work that it paid for. There is nothing to suggest that, as in cost sharing, he expected or wanted the contractor to absorb any part of his cost of doing IR&D work that was properly allocable to Government procurement contracts.

On February 16, 1970, the Comptroller General issued Report B–164912 "Allowances For Independent Research and Development Costs in Negotiated Contracts—Issues and Alternatives."

Both the Senate and House Armed Services Committees commissioned specially constituted subcommittees, for the Senate an Ad Hoc Subcommittee on Research and Development, and for the House an Independent Research and Development Subcommittee, to thoroughly examine the entire matter of IR&D programs with particular emphasis on their nature and the extent to which and the means by which DOD had been bearing the cost of such programs. Each of these subcommittees held hearings: House Hearings on Independent Research and Development; Before the Armed Services Investigating Subcommittee of the Committee on Armed Services under the authority of H. R. Res. 105, 91st Cong., 2d Sess. (1970): Part 3, Senate Hearings on Department of Defense Funding of Contractor's Independent Technical Efforts; Before the Ad Hoc Research and Development Subcommittee of the Committee on Armed Services, 91st Cong., 2d Sess. (1970).

The Comptroller General testified at length before both the House and Senate subcommittees in that order. House Hearings, *supra* at 2–38; Senate Hearings, *supra* at 1875–1919, 2493–2610.

For present purposes the chief significance of the Comptroller General's testimony and the GAO report is that both explicitly advised the Congress that cost sharing was then a typical feature of those advance agreements that the procurement authorities were able to obtain from contractors; that contractors were generally opposed to cost sharing, as were those in some quarters of DOD; and that 1968 proposed revisions to ASPR would no longer provide for cost sharing. House Hearings, *supra* at 4–5; Senate Hearings, *supra* at 1877–78, 2547–53. The GAO report was noncommittal on the merits of cost sharing. It neither approved nor disapproved of its continued use. Senate Hearings, *supra* at 2580–83. Finally, GAO's recommendations to the Congress for improvement in the operation of IR&D funding programs included nothing pertaining directly or indirectly to cost sharing. In testimony before the House Committee the Comptroller General summarized GAO's findings and recommendations as follows (House Hearings, *supra* at 15–16):

> The cost to the Government for DOD and NASA participation in I.R. & D. programs has been rising continuously. These hearings and the coming hearings in the Senate are therefore very timely, particularly in view of the fact that the appropriations for 1970 for R. & D. in DOD and NASA are being reduced.
>
> We believe that it is important that industry maintain its capability to develop new systems for national security. But considering the fact that $16 billion is being spent by the Government for direct R. & D. (half by DOD), the question inevitably arises as to whether the additional cost to the Government of $800 million per year for sharing I.R. & D. and related expense is of comparable value to the Government. If so, the question naturally arises as to whether these programs should not be handled under contracts or at least be required to be relevant to the contract or the agency's direct interest.
>
> We recognize that some differences between agencies in participation in I.R. & D. and related costs may be necessary. Nevertheless, it seems clear that some consistent policy calling for a greater relationship between the

extent of participation and the benefits to be realized would be of advantage to the Government as a whole.

Accordingly, we have included in our report certain recommendations to the Congress, summarized in the digest in the report, as follows:

1. No clear distinction can be made between I.R. & D. and other independent technical efforts, such as bid and proposal efforts; and consequently, any agreed ceilings on I.R. & D. negotiated by DOD or NASA can be avoided through description of an I.R. & D. project under different terminology. We recommend that all contractors' independent technical efforts, including I.R. & D., bid and proposal, and other technical efforts be considered as a single entity.

2. Unlike AEC and NASA, DOD has separate appropriations for procurement and for R. & D. activities, and DOD's share of contractors' I.R. & D. costs generally is borne by the procurement appropriation without identification as I.R. & D. We recommend that, if the Congress authorizes continuation of the present practice of allowing the inclusion of I.R. & D. as an acceptable cost element in negotiated contracts, DOD be directed to break out and identify separately in its appropriation requests the amount estimated as required for this purpose.

3. The policies followed by DOD and NASA on acceptability of I.R. & D. costs differ from those of AEC which allows I.R. & D. costs as an element of overhead only to the extent that they provide a direct or indirect benefit to the contract work. We recommend that a policy be established by the Congress stating the extent to which, and under what circumstances, Government agencies should participate in the cost of contractors' independent technical efforts.

Our report also presents several issues and alternatives for consideration in determining the Government-wide policy on I.R. & D., as follows:

Whether or not the present practice of allowing I.R. & D. as an acceptable overhead cost in negotiated contracts should be replaced by a system of:

(a) Extending the use of direct R. & D. contracts to include those I.R. & D. projects which the agency wishes to support fully or on a cost-sharing basis, thereby providing greater assurance that the desired work will be performed and that the Government will be entitled to information and royal-free rights to any inventions arising therefrom, and

(b) Authorizing an allowance for a stipulated percentage of the remainder of the contractor's total I.R. & D.

effort, irrespective of the source of funding, either as a profit factor or through acceptance as a recognized overhead cost, as an incentive to contractors to continue technical efforts beyond those directly contracted with the Government:

Whether or not allowances to contractors for I.R. & D. should be confined to projects that have a direct and apparent relationship to a specific function of the agency, and

Whether or not, if I.R. & D. allowances by DOD and NASA are continued on the present basis and are not related directly to current or prospective Government procedure, financial support should be provided to companies with similar capabilities which do not hold Government contracts as a means of supporting and strengthening industrial technology.

We include this point because the statement has been made from time to time that the Government is increasing the technology base of American industry, and therefore I.R. & D. indirectly will benefit the Government when it enters in the market for competition. The point here suggested is that that competition ought to exist in the entire industrial sector, not just to those who have Government contracts at a particular point of time.

* * * * *

The principal witness who appeared before both subcommittees on behalf of DOD was Dr. John S. Foster, Jr., that agency's Director of Defense Research and Engineering. House Hearings, *supra* at 251–73; Senate Hearings, *supra* at 1949–2002. The burden of his testimony in each instance was the same. Although acknowledging the need for improvement in the effectiveness of DOD's funding of IR&D, Dr. Foster opposed as impracticable the principal provisions of S. 3003, limiting reimbursable IR&D to that specifically authorized by and directly related to an existing procurement contract. He presented DOD's position on IR&D reform, as follows (House Hearings, *supra* at 267–68):

* * * we have concluded that the type of dollar and technical control and review that will in the long run best satisfy the concerns of the Congress and the GAO and provide the most satisfactory solution to the many complex problems inherent in I.R. & D., and bid and proposal can be achieved within the existing DOD

administrative framework; and that, therefore, further legislation is not necessary. In fact, such legislation could be detrimental to both the Government and industry and therefore would not be in the best interests of the Nation; it could result in more effort that might be of less benefit.

We have just completed a full review of this whole area in detail. We have looked at changes which could increase our control of I.R. & D., and bid and proposal without removing or unduly restricting the features of flexibility and inventiveness upon which the system depends for its value. We have selected a plan approved by the Deputy Secretary of Defense, David Packard, which makes use of both negotiated advance agreements and the DOD-developed formula. We feel these will satisfy congressional concerns and our own, while keeping alive the vital independent nature of this work. The five elements of this approach are set forth below:

1. Use individually negotiated advance agreements for the control and reimbursement of these costs for approximately 100 of the larger defense contractors. This will require that we increase the number of contractors with which we negotiate advance agreements by a factor of almost two. Such agreements, after a formalized detailed technical review of the proposed I.R. & D. program, will establish a separate dollar ceiling for the DOD's reimbursement of each of these costs but will allow the contractor to combine the individual amounts into a single pool if he chooses. We will require the contractor to burden these costs as he would for a contract, except that G. & A. would not be added. The requirement to negotiate an advance agreement will be enforced by automatically establishing a low threshold for recovery of these costs where no advance agreement exists.

2. Strengthen technical review and evaluation of contractors' I.R. & D. programs, as currently established under DOD instruction 4105.52. Establish uniform review and evaluation procedures to be used throughout the DOD. The system will require the review of a company's individual I.R. & D. projects as submitted at the time of the advance agreement.

3. A data bank will be established to provide a centralized body of I.R. & D. project cost and technical information. This information will be available to the Government technical community at large.

* * * * *

4. Use the DOD-developed formula for control and determination of its reasonableness of these costs for the remaining large number of smaller companies who recover I.R. & D. and B. & P. costs. This will provide a workable system that can be uniformly applied—one which will assure results that can be easily monitored and adjusted as needed.

5. The military departments will increase, as necessary, the support and resources needed to effectively perform the required I.R. & D. technical reviews and evaluations.

* * * * *

From the above it is seen that cost sharing was not among the measures that DOD proposed to employ as a part of its efforts to improve the administration of IR&D programs, that omission being consistent with its earlier proposed revision of ASPR to delete endorsement of cost sharing.

On September 18, 1970, the House subcommittee issued a report on its investigation. That report concluded as follows (Report of Subcommittee of the House Committee on Armed Services, 91st Cong., 2d Sess., on Review of Independent Research and Development Program Management, at 13–15):

SUMMARY OF FINDINGS AND CONCLUSIONS

1. Every progressive industrial concern, in one way or another, incurs expenses generated by the necessity to continue to improve its technical capabilities and, in turn, its products or services. This is generally accomplished through the firm's research and development programs. The costs of these essential research and development programs are therefore an accepted cost of doing business, and are recoverable in prices charged to customers—commercial and Government alike.

2. Department of Defense regulations provide that a contractor may be reimbursed for those IR&D costs included in the prices of defense contracts which the contracting officer determines are reasonable.

3. IR&D efforts are generally encouraged by the Government because:

(a) Company-sponsored research and development creates a vast reservoir of technical capability that is immediately available for defense needs.

(b) They promote greater competition by fostering the availability of alternative products and prices to satisfy defense requirements.

(c) They pave the way for technical progress which could not be achieved by the Department of Defense or Department of Defense-sponsored efforts alone.

4. Because of the millions of Department of Defense procurement actions each year and the thousands of contractors and subcontractors involved, there are practical limitations on determining the precise cost of IR&D included in every purchase.

5. Although specific products arising from IR&D can be identified as beneficial to defense efforts, other benefits, such as the creation of competition and maintenance of a widespread technological base, cannot be measured in terms of dollars.

6. Basic research, an element of IR&D, may not have a direct or apparent relationship to immediate Department of Defense needs or operations. However, it is as necessary to the future needs of the Department of Defense and the nation as it is to the future of private business.

7. When Department of Defense procurements are competitively awarded, effective price competition is deemed sufficient to assure the reasonableness of IR&D costs contained in contract prices. When competition is not present, the Department of Defense is obligated to exercise greater surveillance by detailed examinations of IR&D programs to assure that no more than an equitable share is reimbursed by the agency.

8. In 1969 the Department of Defense examined in detail IR&D costs incurred by the larger defense contractors whose defense sales totaled $22.4 billion, approximately half of DOD's purchasing that year. Of the $802 million incurred by these contractors for IR&D, the Department of Defense reimbursed the contractor $393 million.

9. The Department of Defense regularly negotiates advance agreements to support IR&D programs of about 50 major contractors. In the year 1969 this group incurred $643 million for IR&D expenditures and were reimbursed $320 million by Department of Defense payments.

10. *Although the Armed Services Procurement Regulation recognizes that the Government should pay its fair share of Department of Defense-oriented IR&D, it states that in certain cases it may be desirable to pay less than its fair share to create "motivation" for efficiency. The*

latter has become the standard operating procedure. It is achieved by what is known as a negotiated "advance agreement". [Emphasis added.]

11. The Department of Defense has encountered increasing contractor reluctance to accept Department of Defense demands for cost sharing and ceilings in advance agreements.

12. In its two-year study of the Department of Defense's management and control of IR&D, the General Accounting Office found a lack of uniformity among the services in the treatment of IR&D allowances.

13. It is the opinion of the Subcommittee that present weaknesses in Department of Defense procedures and practices relating to IR&D can be rectified administratively. The Comptroller General concurs in this view.

14. The implementation of Section 403, PL 91–121, dated November 19, 1969, will probably result in increased costs of Department of Defense administration and contractor record keeping for five to seven years in the future and net savings are doubtful.

15. The Department of Defense has adopted the following new procedures designed to improve the management of IR&D:

(a) The use of negotiated advance agreements for the control and reimbursements of IR&D costs will be expanded to all of the major defense contractors on a basis which will encourage participation of contractors.

(b) The policy of expediting the negotiation of advance agreements will be encouraged by reducing recovery of these costs where no advance agreement exists.

(c) Technical reviews and evaluations of contractors' IR&D programs will be strengthened, and uniform procedures will be promulgated to assure that Government interests are protected.

(d) With respect to the large number of small defense contractors not subject to negotiation of advance agreements, the Department of Defense will develop appropriate formulas for the control and determination of reasonableness of IR&D costs reimbursed under defense contracts.

(e) A data bank will be established to provide a centralized body of IR&D technical information for use in the Department of Defense's overall planning of its Research and Development program. This information will be made available to the Government technical community at large.

(f) The Department of Defense will increase as necessary the support and resources to effectively perform the

required IR&D technical reviews and evaluations and approval of reimbursements of IR&D costs.

RECOMMENDATIONS

The Subcommittee recommends:

1. That control of defense expenditures for IR&D, B&P and OTE be achieved through improved Department of Defense administration, coupled with adequate oversight, rather than through legislated ceilings.

2. That Section 403, PL 91-121, dated November 19, 1969, be repealed.

3. That the Department of Defense

(a) Segregate the costs of B&P and OTE in the negotiations of advance agreements for IR&D;

(b) *expand the use of advance agreements* to include all firms receiving $2 million or more annually from the Department of Defense as partial reimbursement for IR&D expenditures, *provided the use of cost sharing arrangements be eliminated;* [Emphasis added.]

(c) provide appropriate right of appeal where, in the absence of an advance agreement, the Department of Defense establishes a recovery of costs which a contractor claims is less than the amount of its fair share;

(d) develop uniform regulations which will provide clear guidance to all services as to policies, practices and procedures to be followed in the establishment of allowable IR&D costs and the negotiation of IR&D advance agreements; and

(e) provide the appropriate Congressional committees with annual reports of the IR&D payments made to major contractors during the past fiscal year.

4. Although basic research conducted as IR&D is vital to DOD and national interest, it cannot be always directly related to a DOD operation or function. Therefore, the Subcommittee recommends that the criteria of relevancy not be used as a determining factor in the support of *basic research* efforts of contractors.

Senator Proxmire testified in support of S. 3003 before the Senate subcommittee. 3 Senate Hearings, *supra* at 1641-75. The following colloquy between Senators Symington and Proxmire clearly demonstrates that despite his extreme dissatisfaction with DOD's performance in the administration of funding for IR&D, Senator Proxmire had

no desire to require a contractor to absorb, as in cost sharing, any part of IR&D cost that was properly allocable to Government procurement (3 Senate Hearings, *supra* at 1663–65):

SENATOR MCINTYRE. Senator Symington?

SENATOR SYMINGTON. Mr. Chairman, I am not a regular member of the subcommittee, and I yield if it meets with the Chair's approval to my distinguished colleague from Massachusetts, and then perhaps you would allow me to make a couple of comments and ask a couple of questions.

SENATOR BROOKE. Mr. Chairman, I will be pleased to yield to the Senator.

SENATOR SYMINGTON. You are very kind.

TRUE PRODUCT COST

First, Senator, I want you to know that I am very much impressed with your statement. I think it is thought-provoking, and although at times I think it is a little harsh, I think it is a constructive statement.

The question of cost is always a difficult matter to decide. There was a time in my life when I was selling Sears, Roebuck over a period of years on a cost-plus basis, and I had to meet all outside competition under the contract, which ran into millions of dollars a year, and therefore it was very difficult to sell them on what was or was not cost as against the opinion of the buyer, so I think I have had as much experience on what is cost as any Senator.

Then later in my life I worked for the Army and the Army Air Corps and the Navy, and the question would come up what part of the plant was or was not working for one of the three services, and all the various cost departments of the three services or at least in effect the Army Air Corps by that time was a service would disagree and the matter would ultimately be decided by the General Accounting Office.

So I think that your paper is most constructive.

As I understand it, what you are trying to do is to establish what is true cost. Am I correct on that?

SENATOR PROXMIRE. *That is correct.*

SENATOR SYMINTGON. What is the true cost of a product, and that you believe that the cost of the product and the cost of the research incident to the product in the same or comparable contracts can be made without in effect having an overall research contract that can be

applied at will by the contractor without the proper check. Is that correct?

SENATOR PROXMIRE. That is right. Without the proper check, without the proper knowledge, without requiring—it seems to me that it is most important that the Congress at least know what we are doing, know what we are funding, and not have this vague, amorphous kind of thing in which the contractor does whatever he wants to do.

SENATOR SYMINGTON. In previous contracts which you have criticized in the Joint Economic Committee of which I have the privilege of being a member, I must say at first that I thought you were wrong, but the proof that you were right lies in the fact that in recent contracts that have been given out, there have been major changes in the contracts to adjust the problems that you brought up at that committee.

In [t]his case, with the superb work that was done last year by the chairman of this subcommittee, I am confident that before these hearings are over we will have a better understanding of what is true cost. I am also confident that Secretary Laird and Secretary Packard, who together are probably the best and most experienced team we have ever had in this position, will fully support anything that is brought up by this subcommittee to find out what is the true cost of a product.

For that reason I look forward to reading these hearings carefully, and forming my own opinion on it to present that opinion to my friend, the able and constructive chairman of the subcommittee, and to discuss it further on the floor.

Mr. Chairman, I appreciate the Senator from Massachusetts yielding to me, I have to go up to another hearing, and therefor I especially appreciate it, and I want to thank you for your courtesy in letting me appear this morning.

SENATOR PROXMIRE. If the Senator from Missouri will just yield for a quick response let me say what he has said is exactly, he said it much more concisely and better, but exactly what I am trying to get at.

What I favor is the Federal Government paying for the true cost, and if accountants or other experts can show that something that is not now included or thought of as a cost should be I am all for it.

SENATOR SYMINGTON. *Paying for the true cost* plus a fair profit under our system.

SENATOR PROXMIRE. *Exactly,* yes indeed, a fair profit of course. I think that is right and that should be added,

but I think *it is clear to me that at the present time we are not expending this independent R.D.T. & E., independent, for anything that the Federal Government really gets, at least we get very little of it,* and that there are much better ways of doing this.

SENATOR SYMINGTON: Thank you. [Emphasis added.]

* * * * *

Unlike its House counterpart, the Senate subcommittee issued no report at the conclusion of its deliberations on IR&D.

In summary, the record of proceedings before the two subcommittees clearly reflects that at that juncture cost sharing was not regarded by anyone concerned as a device that ought to be a part of the effort to improve the ground rules governing DOD's financial participation in future IR&D programs. The subcommittee membership was made expressly aware both that cost sharing had been extensively used in such advance agreements as DOD had been able to obtain in the past and that the agency had issued proposed revisions to ASPR that would no longer permit such use. GAO, fully mindful of both of these considerations, did not endorse cost sharing as a useful element of the reform program that it proposed. DOD opposed any statutory constraints on IR&D funding, urging that all needful controls could be implemented administratively. Cost sharing was not among the panoply of control measures that it proposed to that end. Predictably, industry spokesmen were uniformly opposed to cost sharing. The House subcommittee, endorsing DOD's position that corrective legislation was neither necessary nor appropriate, expressly conditioned its approval of mandatory advance agreements for large contractors on the proviso that "* * * the use of cost-sharing agreements be eliminated." Report of House subcommittee, *supra* at 15. Most significantly of all, Senator Proxmire, the harshest critic of DOD's then current IR&D practices and the foremost advocate of the need for remedial legislation, specifically disclaimed the sole objective that cost sharing is designed to achieve; the enforced absorption by a contractor of a portion of IR&D cost that on the merits is allocable to defense contract work.

The question thus becomes that of determining whether the essentially unanimous sentiment on cost sharing, as indicated above, underwent any discernible change in the subsequent course of adoption of H. R. 17123, 91st Cong., 2d Sess., the bill that evolved into Pub. L. No. 91–441.[2]

On April 24, 1970,[3] the House Armed Services Committee issued its report on H. R. 17123, H. R. REP. No. 91–1022, 91st Cong., 2d Sess. On the subject of IR&D the report stated as follows (at 43):

> Independent Research and Development (IR&D) is generally defined as that part of a contractor's total research and development effort which is not performed pursuant to a direct grant or similar agreement. In view of the substantial cost of such efforts in prices charged DOD by major defense contractors, the Armed Services Committee initiated a comprehensive review of Defense Department support of IR&D to determine the reasonableness of charge and adequacy of agency control of contractor programs.
>
> Accordingly, the Armed Services Investigating Subcommittee held hearings as part of an extensive study of this type of advanced research.
>
> The Subcommittee has reported to the Committee at this time that no evidence has surfaced which supports a conclusion that significant waste or inefficiency exists in the conduct of independent research and development. The Subcommittee stated that a Congressional funding limitation on the support of IR&D activities in the contractors' plants is unwarranted at this time and would unnecessarily impair the overall R&D activities in the Department of Defense.
>
> The Subcommittee has identified administrative inconsistencies in the supervision of such programs. It is continuing its in-depth analysis of this complex procurement area and expects to file a comprehensive report later in this session of Congress.

As consonant with the views expressed in the report of the Armed Services Committee, H. R. 17123, as it passed the House on May 6, 1970,[4] contained no new provisions dealing with IR&D.

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[2] Note 1, *supra*.

[3] 116 CONG. REC., Part 10, at 13077.

[4] 116 CONG. REC., Part 11, at 14492.

On July 14, 1970, the Senate Armed Services Committee issued its report on H. R. 17123. S. REP. No. 91–1016, 91st Cong., 2d Sess. Concerning IR&D, the report said (at 96–99):

SECTION 203—DEPARTMENT OF DEFENSE FUNDING OF CONTRACTORS' INDEPENDENT TECHNICAL EFFORT

Background

The fiscal year 1970 Military Procurement Authorization Act, Section 403, established a limitation which provided that payments for independent research and development, bid and proposal, and other technical effort costs to contractors would not exceed 93 percent of the total amount contemplated for such purpose. This was an interim provision. It was agreed that the Committee would investigate the issue in depth in its consideration of the fiscal year 1971 authorization request.

The term IR&D, as commonly used, but more properly referred to as contractor independent technical effort includes three elements. These are independent research and development (IR&D), bid and proposal (B&P) and other technical effort (OTE). IR&D as one of these elements, is generally defined as that part of a contractor's total research and development program which is not performed under a specific contract, grant or similar agreement, and which is undertaken in areas at the discretion of the contractor. Bid and proposal represents costs incurred by contractors in the preparation of bids or proposals to the Department of Defense for new weapons systems or components. The difference between B&P and IR&D lies in the purpose for which the work is done. If it is done without the intent of including the results in a specific proposal, but has the more general aim of developing processes, products, or service capability, it is called IR&D. Other technical effort (OTE) encompasses a group of miscellaneous technical activities performed by contractors which is not identified either as IR&D or B&P. It is a hybrid classification which has grown up as an accounting convenience. The Department of Defense has proposed the elimination of this classification and the inclusion of such items under either the IR&D or the B&P categories.

Alternatives

The Committee's Ad Hoc Subcommittee on Research and Development held extensive hearings during which the Department of Defense, General Accounting Office,

Atomic Energy Commission and four industry associations testified. Senators Proxmire and Cranston also appeared before the Subcommittee.

The Subcommittee was faced with three alternatives:

1. Recommend that no legislation be enacted so that Congress would continue to exercise no control over these payments.

2. Recommend adoption of S. 3003, which would be very limiting both as to the amounts and purposes which would qualify under this proposal.

3. Recommend a new provision which would provide a reasonable and feasible measure of control by the Congress, and which would not unduly burden the Department of Defense and industry with cumbersome and costly procedures.

Recommendation

The Committee's proposed amendment reflects the selection of the third alternative and *has four main features:*

(1) It would require the Defense Department to negotiate advance agreements with all contractors who, during their preceding fiscal year, received IR&D, B&P, and OTE payments in excess of $2,000,000.

The number of contractors covered by this provision would be approximately 50, the same approximate number with whom advance agreements are presently signed. Accordingly, there would be no major expansion of the number of individual negotiations in which the Department would have to engage.

These agreements, however, would have to cover not only the IR&D programs of these contractors, but their B&P and OTE programs as well. The Defense Department has acknowledged that an expanded ceiling of this kind is needed if a solution is to be found to the present practice whereby companies subvert their IR&D ceilings by classifying certain expenditures in the B&P and OTE accounts.

While only 50 or so companies will be covered by this $2 million threshold, these companies account for the great bulk of all auditable independent technical effort funds disbursed by the Department, which amounted to 93.1% in 1968 and 95.6% in 1969.

(2) It would require that the IR&D portions of these advance agreements be accompanied by technical evaluations of contractors' proposed IR&D programs. These evaluations must be improved if the Department is to be assured that the work done is of great potential value to its future needs.

(3) It would require that no payments be made for IR&D, B&P, and OTE work not relevant to the functions and operations of the Department of Defense. This provision should serve as a directive to the Department to avoid a recurrence of the isolated past instances in which Department funds have been used to fund the research of contractors on commercial products.

(4) It would establish a ceiling of $625,000,000 on the payments to be made pursuant to the advance agreements required to be negotiated during fiscal year 1971.

The Department of Defense opposes the establishment of such a ceiling. However, the Committee is convinced that a ceiling is essential if the Congress is to be assured that costs in this area do not continue to rise at an unacceptable rate, and to provide the basis for an annual review of this program.

It has given considerable attention to the alternative types of ceilings it could establish and has rejected both line item control and a ceiling based on a given year's funds as administratively unworkable. The approach actually chosen will require the Department to do nothing more than to divide the $625,000,000 available to it among the 50-odd companies with which agreements are required.

The Military Departments have provided the Committee with estimates indicating projected total payments for contractor independent technical effort programs of $656 million for the year 1970 and $645 million for the year 1971, compared with the $759 million reported for 1969. Although these amounts are recognized as estimates, their downward trend is consistent with the ceiling of $625 million recommended by the Committee. Indeed, since the $625 million ceiling covers only those large companies who may be expected to receive about 95% of the total payments made, the ceiling actually affords the Department leeway to exceed its present estimates.

Consideration of S. 3003

A primary purpose of the Committee hearings was the evaluation of S. 3003. The Committee recommends against enactment of S. 3003 because in its view this bill would produce a series of adverse effects on both the Defense Department programs and defense industry which would far outweigh any of its benefits. S. 3003 would prohibit the reimbursement of a company for its IR&D and OTE costs unless such costs were specifically provided for in a given contract. In such event, the contractor in question would have to submit to the

Defense Department a technical appraisal of each IR&D project covered, and reimbursement would not be allowed unless the work at issue was of direct or indirect benefit to the work being performed under the contract.

S. 3003 also would restrict reimbursement for B&P costs by providing a ceiling of one percent of the direct materiel and direct labor cost of the contract under which these reimbursements would be made.

The provisions of S. 3003 relating to IR&D and OTE would eliminate much of the contractor independence which is so important because it permits contractors a wide degree of latitude in pursuing promising goals. The overall effect of a system under which all IR&D projects had to be contracted for specifically would be the elimination of IR&D as it is presently known and the substitution of direct contracting as a universal policy.

This would result in significantly higher administrative costs for the Defense Department as well as a marked decrease in the amount of research work performed by defense industry. Such a decrease would inevitably occur because of the stringency of an elaborate administrative system. The flexibility which contractors presently enjoy in the process of trial and error necessary to the solution of technical problems would be lost.

The proposed limitation on B&P reimbursement as a percentage of direct material and labor costs is not meaningful because such expense has no direct relationship to these costs. It is related to the contractor's backlog of work and the magnitude and complexity of the equipment on which he quotes. As a result, B&P expenses fluctuate considerably between contractors and for individual contractors from year to year. A common formula as proposed by S. 3003, therefore, is not meaningful.

While the Committee is convinced, as a result of its hearings, that enactment of S. 3003 is not advisable, it is also convinced that Defense Department administration can be significantly improved and the costs of these programs reduced. The Committee was disturbed by recent increases in the total spending by the Defense Department for this program. Between 1963 and 1969 the amount increased from $459 million to $759 million, a rate of growth significantly greater than the rate of growth in the Defense Department procurement budget.

Department of Defense Plan

The Department of Defense proposed the following 5 point plan as a means of overcoming these problems.

(1) The improved use of individually negotiated advance agreements for the control and reimbursement of these costs for approximately 100 of the largest defense contractors.

(2) A strengthening of the Department's technical review and evaluation procedures in this area.

(3) Establishment of a data bank to provide a centralized body of IR&D project cost and technical information.

(4) The use of a standard formula in determining the reimbursable costs of the large number of small contractors whose volume of sales to the Department does not justify the negotiation of advance agreements.

(5) An increase in the resources of the military departments such as is necessary to permit implementation of the first four points.

Conclusion

The Committee supports the Department in its efforts to improve its administration in this complex area, and *urges strongly that immediate steps be taken to implement the above plan,* consistent with the amendment proposed by the Committee. The Committee *believes also,* however, *that the importance of* contractor *independent technical effort programs to our security, and the amount of money used annually to fund them, both justify broad legislative controls by the Congress in this area.* [Emphasis added.]

While the Senate Committee favored prompt implementation of the administrative measures proposed by DOD in lieu of legislation, it did not regard those measures as sufficient in themselves. Rather, it felt that they required fortification by the imposition of "broad legislative controls" which it identified as four in number, *viz,* mandatory advance agreements for previous recipients of large IR&D reimbursements; thorough technical scrutiny by DOD of contractors' IR&D proposals; an outright prohibition of reimbursement for IR&D not demonstrably relevant to the functions or operations of DOD, an absolute annual ceiling on the amount of IR&D payments that DOD could make pursuant to advance agreements. Significantly, neither the DOD-proposed administrative measures nor the legislative controls embraced the principle of cost sharing.

To accomplish the above objectives the Committee referred H. R. 17123 to the full Senate on July 23, 1970,

with the following provision concerning IR&D (116 CONG. REC., Part 19, at 22591):

> SEC. 203. (a) Funds authorized for appropriation to the Department of Defense under the provisions of this Act or any other Act shall not be available for payment of independent research and development, bid and proposal, or other technical effort costs *unless the work for which payment is made is relevant to the functions or operations of the Department of Defense and unless* the following conditions are met—
>
> (1) the Secretary of Defense, prior to or during each fiscal year, negotiates advance agreements establishing a dollar ceiling on such costs with all companies which during their last preceding fiscal year received more tha[n] $2,000,000 of independent research and development, bid and proposal, or other technical effort payments from the Department of Defense, the advance agreements thus negotiated (A) to cover the first fiscal year of each such company beginning on or after the beginning of each fiscal year of the Federal Government and (B) to be concluded either directly with each such company or with those product divisions of each such company which contract directly with the Department of Defense and themselves received more than $250,000 of such payments during their company's last preceding fiscal year;
>
> (2) the independent research and development portions of the advance agreements thus negotiated are based on company submitted plans on each of which a technical evaluation is performed by the Department of Defense prior to or during the fiscal year covered by such advance agreement;
>
> (3) no payments for independent research and development, bid and proposal, and other technical effort costs are made by the Department of Defense to any company or product division with which an advance agreement is required by subsection (a)(1) of this section, except pursuant to the terms of that agreement; and
>
> (4) *the total dollar value of the advance agreements* negotiated prior to or during a given fiscal year as required under subsection (a)(1) of this section *does not exceed a ceiling to be established annually by the Congress.*
>
> (b) In the event negotiations are held with any company or product division with which they are required under subsection (a)(1) of this section, but no agreement is reached with any such company or product division—

(1) no payments for independent research and development, bid and proposal, and other technical effort costs shall be made to any such company or product division during the fiscal year for which an agreement was not reached, except in an amount substantially less than the amount which, in the opinion of the Department of Defense, such company or product division would otherwise have been entitled to receive; and

(2) the amount of money received by that company for independent research and development, bid and proposal, and other technical effort costs during its last preceding fiscal year shall be included in determining compliance by the Department of Defense with the ceiling established by Congress, pursuant to subsection (a)(4) of this section, for the fiscal year in question.

(c) The Secretary of Defense shall submit an annual report to the Congress on or before January 31, 1972, and on or before January 31 of each succeeding year, setting forth—

(1) those companies with which negotiations were held pursuant to subsection (a)(1) of this section prior to or during the preceding fiscal year, together with the result of those negotiations;

(2) the manner of his compliance with the ceiling established by Congress for the preceding fiscal year pursuant to subsection (a)(4) of this section; and

(3) the latest available Defense Contract Audit Agency statistics on the independent research and development, bid and proposal, and other technical effort payments made to major defense contractors whether or not covered by subsection (a)(1) of this section.

(d) The provisions of this section shall apply only to contracts for which the submission and certification of cost or pricing data are required in accordance with section 2306(f) of title 10, United States Code.

(e) The ceiling to be established pursuant to subsection (a)(4) of this section for fiscal year ending June 30, 1971, shall be $625,000,000.

(f) Section 403 of Public Law 91–121 (80 Stat. 204) is hereby repealed. [Emphasis added.]

That cost sharing formed no part of the Senate's approach to controlling DOD's expenditures for IR&D is evidenced by that body's debate on H. R. 17123, as amended by its Armed Services Committee. At the outset, Senator Proxmire identified the basic flaws that he sought to correct (116 CONG. REC., Part 19, at 25762):

MR. MCINTYRE. * * * I think what we all realize on the subcommittee is that we must maintain our technological base and do it in a most efficient manner.

MR. PROXMIRE. I agree with that wholeheartedly.

I would like to make one other point with the Senator from New Hampshire. This refers to independent research and development. As the Senator knows, I offered an amendment last year, which was accepted in part, very graciously, by the Senator from Mississippi (MR. STENNIS) and the Armed Services Committee, and it was held in conference. SENATOR STENNIS suggested I introduce a bill, on which hearings could be held. As the Senator has stated, it is enormously important—$625 million is involved. I understand 95 percent goes to 50 companies, or an average of $12 million to a company.

Of course, it is very lucrative and highly profitable to have thousands of dollars for independent research and development. *There is no line item; the accountability has been vague in the past.* I am delighted that *the Senator, as I understand it, has made this an identifiable item and put a ceiling on it*—a ceiling which, as I understand, is below the ceiling we have had heretofore. So I think this is a very commendable improvement over our past operations, and I think the Senator from Mississippi (MR. STENNIS), the Senator from New Hampshire (MR. MCINTYRE) and other members of the committee, but especially Senator MCINTYRE, who is responsible in this area, deserve a great deal of credit and the thanks of the Senate.

MR. MCINTYRE, I thank the Senator. As I indicated to the Senator privately, I shall have a more detailed statement later on I.R. & D. I will say now, however, that most of the committee agreed that independent research and development is one area where we get great value for our research dollars.

MR. PROXMIRE. *What bothers me about the independent research and development is that there is no accountability.* We were not able to see what we got, and in case after case, it turned out that the money was spent on matters which have no connection whatever with the military. In one case it was spent on urban development, as I recall. *I believe that if the taxpayer is paying for one purpose, he should have the money spent for that purpose devoted to it.*

MR. STENNIS. Mr. President, will the Senator yield to me further on that point?

MR. PROXMIRE. I yield.

MR. STENNIS. As long as we are speaking about where the credit goes, the Senator from Wisconsin is entitled to

a great deal of credit on the item of research as a whole, and that specific part to which he has just referred, the independent research. In the Proxmire amendment and then in the Proxmire bill, he has not only brought a fine, intelligent focus on and presentation of it, but he has spurred us on in our work as well, and I want to publicly thank him now, as I have already done in private. [Emphasis added.]

After Senator McIntyre, Chairman of the Ad Hoc Subcommittee on Research and Development, had given a detailed account of the subcommittee's perceptions and recommendations (116 CONG. REC., Part 19, at 26361–63). Senator Proxmire sought direct confirmation of his own understanding of the purpose and effect of the proposed amendment to the House version of H. R. 17123, as follows (116 CONG. REC., Part 19, at 26363–64):

MR. PROXMIRE. I congratulate the Senator from New Hampshire on an excellent speech and for the excellent job he has done in respect to the complex subject. I have talked to a number of Senators who have told me that Senator McIntyre has done remarkable work in this area for several reasons. For one thing, it is complicated. Few people are aware of it. It was brought up last year and a number of the members of the committee said that they knew nothing or very little about it. So that the Senator from New Hampshire has gotten into a field that has been so complicated there has been little knowledge, discussion, debate, or very little understanding about it.

In the second place, as I understand the thrust of the recommendations of the Senator which he has listed to the purpose of the recommendations, they are not to discourage military research. Quite the contrary. *The purpose of the recommendations is to encourage research and make it relevant and more effective, and to permit the Department of Defense and those who have the responsibility in Congress and elsewhere to know what is going on* and what is being done, so that we will be in a position to appropriate money with critical understanding and knowledge.

I should like to ask the Senator from New Hampshire if that is not his principal objective?

MR. MCINTYRE. I would say to my good friend from Wisconsin that the subcommittee's recommendations to the full committee, and the committee's adoption of

them, constitute a genuine attempt to improve rather than curtail our defense research programs.

Last year, when the Senator from Wisconsin offered his amendment, it was a big surprise to me. Even though I had been chairman of the Subcommittee on Research and Development and was, presumably, somewhat knowledgeable in the whole field, I had never heard of independent research and development. As the Senator knows, it does not exist within the R.D.T. & E. section of the budget. It is actually found scattered all through the procurement items.

For this reason, we regarded the amendment of the Senator from Wisconsin as an open invitation to examine into this field, to see what we could do about bringing a quiet hand of control over an area of defense expenditures which no one in Congress knew very much about. *We feel that our amendment will serve to keep the feet of the Department of Defense to the fire in its pledge to improve its administration of this program.*

MR. PROXMIRE. *Let me see if I understand how the distinguished Senator from New Hampshire would go about this.*

In the first place, the committee recommends that the Department of Defense will work with the big contractors, those who receive $2 million or more. This would cover not only what is technically called independent research and development but also bids and proposals and other technical efforts. Those two categories have been vague and ill defined. As a matter of fact, as I recall, even at the hearings, there was some disagreement as to what that meant. But this $2 million would be required in advance to cover those two categories; is that not correct?

MR. MCINTYRE. That is right.

MR. PROXMIRE. *In the second place,* as I understand it, *it requires* that there be a technical evaluation by Defense—the committee recommends that there be—*that the agreement be accompanied by a technical evaluation, so that there will be some clear understanding of* the negotiations, *how it relates to the defense effort,* what it would contribute to, and whether it would be worth the amounts required.

MR. MCINTYRE. The Department of Defense does give a certain amount of time already to evaluation of brochures submitted by companies on these [I.] R. & D. programs.

MR. PROXMIRE. That is about it. That has been the trouble. They look in the brochures and evaluate them, but this would go farther than just evaluating a brochure

put out by a company. Those companies are skillful in making their brochures look attractive, but *we must go behind the brochures to determine what the money is actually going to buy,* and try to determine not only what the costs will be for each item but whether the items are technically feasible.

MR. MCINTYRE. I agree wholeheartedly. I would also point out to my good friend from Wisconsin that when we speak of brochures, we are speaking of very sizable items.

They are often two or three times the size of a phone book of a large metropolitan area.

The word "brochure," as such, is really a misnomer. These brochures are vast and complicated.

MR. PROXMIRE. I did not mean to impugn them just because we called them brochures. What I meant was, to be somewhat skeptical about what the DOD is doing, whether it is doing a reasonably good job now in evaluating independent research and development.

The General Accounting Office had a very difficult time getting examples from them, and those we did get indicated very often that substantial expenditures were made in areas that did not have the remotest connection with defense. It would take a great imagination to conceive of ways in which they could have been related to defense. They were connected with urban renewal. One case I recall was devoted completely to domestic efforts, which might have been commendable but should have been specifically authorized and should not have been paid for under the guise of being for defense.

As I understand it, this evaluation will determine not only costs but also the feasibility and its relevance to defense work.

MR. MCINTYRE. That is right.

MR. PROXMIRE. That is underlined by the third amendment—*the third recommendation* to which the Senator from New Hampshire referred, *that no payment would be made for either I.R. & D. bids and proposals or other technical efforts which are not relevant to the purposes of the Department of Defense.*

MR. MCINTYRE. That is our hardnosed position at this time.

MR. PROXMIRE. *Finally,* I think the proposal made by the Senator from New Hampshire, that the ceiling of $625 million [im]posed, is realistic and sensible. *It is very important to get that ceiling,* not only from the standpoint of saving the taxpayers' money in areas where we have not really known what it has gone for, but much more important, to provide an incentive for the Depart-

ment of Defense to make sure that the limited amounts of money for the projects will be for projects to help give this country its strongest military force.

MR. MCINTYRE. I hope that my good friend from Wisconsin understands that our ceiling is directed to the 50 companies doing $2 million or more work, which, we have found, account for 95 percent of all auditable I.R. & D. payments, but that there is a leeway over and above the ceiling of $625 million that could encompass another $20 to $40 million for the thousands of smaller companies which do some of this I.R. & D. work.

MR. PROXMIRE. I think that is a practical accommodation, especially for a first effort. I hope that the committee, when giving its attention to this, will watch how it operates, and will consider the possibility of, perhaps, extending the ceiling further, especially if the area of I.R. & E. expenditures, which is exempt, should turn out to be greater than the $25 million or the $30 million which is anticipated. [Emphasis added.]

* * * * *

After setting forth his own assessment of the problems associated with IR&D and the need for remedial legislation,[5] Senator Proxmire unreservedly endorsed the adequacy of the committee and subcommittee recommendations, as follows (116 CONG. REC., Part 19, at 26365):

Mr. President, *I feel that these recommendations will provide the needed controls over the independent research and development program.* While they do not include all of the provisions of S. 3003, I urge the Senate to accept the committee's amendment. Once again I want to commend the fine work of the distinguished Senator from New Hampshire (Mr. MCINTYRE) and the other members of the Research and Development Subcommittee for the excellent job they did in looking into this extremely complicated and difficult program. I believe their recommendations will solve many of the problems which have plagued the independent research and development program. They will strengthen not only the administration of the program but also guarantee that all work done will be of value to the Department of Defense. I am delighted that the committee has accepted the major part of my proposal and that the committee's recommendations have been largely accepted by the

[5] 116 CONG. REC., Part 19, at 26364–65.

Department of Defense. *I urge that the Senate approve the committee amendment.* [Emphasis added.]

Despite subsequent objection by Senator Cranston to both the ceiling limitation and relevancy requirement of the committee provision,[6] the Senate passed H. R. 17123 on September 1, 1970, with the committee version of section 203 intact. 116 CONG. REC., Part 23, at 30724.

On September 14, 1970, the House disagreed to the Senate amendments to H. R. 17123 and called for a conference. 116 CONG. REC., Part 24, at 31437. Senate and House conferees were thereafter appointed. 116 CONG. REC., Part 24, at 31764, 32191.

On September 26, 1970, the conferees issued their report. H. CONF. REP. No. 91–1473, 91st. Cong., 2d Sess. The report explained the actions taken with respect to IR&D as follows (at 21–22):

> The Senate adopted language in Section 203 which provided for the following:
>
> (a) Restricted payments to contractors for independent research and development (IR&D), bidding and proposal (B&P) and other technical effort (OTE) work which is relevant to Defense functions and operations.
>
> (b) Required negotiation of advance agreements with all contractors who received more than $2 million in IR&D, B&P, or OTE in their last preceding year.
>
> (c) Required that negotiations of advance agreements be based on submitted plans and a technical evaluation of the IR&D portion of those agreements.
>
> (d) In the event negotiations are held with any company required to enter into an advance agreement, but no agreement is reached, reimbursement would be made in an amount substantially less than the contractor otherwise would have been entitled to receive.
>
> (e) The Department of Defense was required to report to Congress with regard to IR&D, B&P and OTE expenditures.
>
> (f) Established a ceiling of $625 million on payments to be made pursuant to advance agreements negotiated under the act, and
>
> (g) Repeal of Section 403 of the fiscal year 1970 act which limited payments for IR&D, B&P and OTE to 93 percent of the total cost contemplated by the Department.

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[6] 116 CONG. REC., Part 19, at 26365–67.

The House version of the bill contained no comparable language.

Early this year a House Armed Services Subcommittee held hearings and issued a report on IR&D. The Subcommittee concluded that the control of defense expenditures for IR&D, B&P and OTE could be achieved through improved administration, coupled with adequate oversight, rather than through legislation. The recommendations of the Subcommittee were similar to the Senate language with the exception of the establishment of a ceiling and the section regarding relevancy.

The Senate conferees maintained that greater congressional oversight was necessary to assure adequate controls over governmental payments for IR&D, B&P and OTE to defense contractors. *The House conferees acceded to the Senate where the language coincided with its subcommittee recommendations.* However, in the opinion of the House conferees, specific ceilings on the total DOD reimbursement and the language with respect to relevancy were not acceptable. [Emphasis added.]

Control through restrictive congressional ceilings

The provisions of the Senate language established a ceiling of $625 million for the DOD reimbursement of IR&D B&P and OTE costs to approximately 50 major contractors and was applicable to payments under cost type contracts only. The House conferees considered this provision as a line item in the authorizing procedure. During its hearings, it was established that such a line item provision was administratively impractical. Moreover, upon examination of the computation of the Senate ceiling amount, in the view of House conferees, it was found that it was, at best, an arbitrary amount, and there were questions as to the relationship of the ceiling with costs incurred by the affected contractors and contracts. The Senate conferees conceded to the House position and the language related to the establishment of a ceiling was deleted.

Relevancy

The House conferees agreed with the basic aim of the Senate language which required that payments should be made only for IR&D, B&P and OTE that was related to department functions or operations. However, with respect to basic research conducted as IR&D it cannot always be directly related to a DOD operation or

function. Basic research is that type of research which is directed toward increase of knowledge in science rather than an application to a specific product. The development of such fundamental achievements in science is vital to military research and national interests. The House conferees were of the opinion that the relevancy phrase in the Senate language would unduly inhibit the conduct of needed basic research. The conferees agreed to delete the reference to relevancy and substitute the words "in the opinion of the Secretary of Defense, a potential relationship to a military function or operation" to assure a broad interpretation of the relationship of basic research to military requirements.

Other Technical Effort (OTE)

The conferees agreed to eliminate legislative references to OTE because of the lack of specific definition of this category of cost. The Department in its testimony before the House Subcommittee on IR&D stated that OTE as a category of cost would no longer be used and that greater efforts would be made to correctly classify "OTE" costs as IR&D or B&P, or otherwise in the negotiation of agreements and contracts.

Most pertinent for present purposes is the statement in the conference report to the effect that the House conferees had only agreed to those provisions of section 203 that harmonized with the recommendations of the House Subcommittee on IR&D. That subcommittee, it will be recalled, only agreed to the mandatory requirement for advance agreements by large contractors on condition that "* * * the use of cost sharing arrangements be eliminated." Report of Subcommittee of Committee on Armed Services, 91st Cong., 2d Sess. (September 18, 1970) at 15. The House agreed to the conference report on September 29, 1970. 116 CONG. REC., Part 25, at 34161.

In reporting the results of the conference to his Senate colleagues Armed Services Chairman Stennis frankly acknowledged the intransigence and resultant predominating influence of the House conferees on the shape of the compromise agreement. He explained (116 CONG. REC., Part 26, at 34581):

Mr. President. SENATOR MCINTYRE will comment at length on the final provision with respect to I.R. & D.

The key feature of the Senate provision was the $625 million ceiling which would have been imposed on the level of effort in this activity. The House would accept no dollar limitation on this matter. Certain language was agreed to, however, which does require advance agreements between the Department of Defense and the contractor.

Mr. President. *I greatly respect the position of the House but at the same time I exceedingly regret that more progress could not be made in the control of the so-called I.R. & D. activity.* It is my observation that this program has not been properly managed in the Department of Defense for the past few years and much needs to be done to prevent abuse in this program which is now at an estimated cost of about $700 million a year.

I firmly believe that this entire matter should be kept under continual and intensive oversight by the Congress and I wish to give notice at this time that I intend to pursue this course of action. No program, however important, is not properly managed if managed in such a way that effective legislative oversight is impossible.

We had some sharp disagreement with reference to the language that goes to the research problem and the independent research problem. It is an important matter, but it is a problem to get it in such shape that Congress can give it proper legislative surveillance, because proper legislative surveillance is something which is more important than the exact amount we might appropriate for items. We can well disagree as to amounts, but we should all agree that an item is not to be approved unless we can have some semblance of a reasonable legislative surveillance and supervision over it, varying according to degree to the subject matter.

We got the best we could with reference to this research. The conferees did everything they could. *Someone asked me: "Why did not the House conferees agree more than they did with reference to the amendments?"* I am sure they were as honest and sincere as we were, but I remember that our former colleague from Arizona, Carl Hayden, gave a mighty good answer here, one time, on a conference report, where he was sharply questioned by someone as to why the Senate did not get a better agreement and specifically why the House would not agree on that point. He said, "Well, they were opposed to it."

I cannot improve on that. *They were just opposed to a lot of these provisions.* And, as I say, I am sure it was in all sincerity.

I think it is something that can be and should be worked on more. We should keep on, and we will get a better system out of it.

I am going to insist on the Secretary of Defense and Dr. Foster, the Assistant Secretary of Defense in charge of research and development, helping to formulate a better plan that, regardless of the amount of money, can be handled in such a way as to have this surveillance on independent research and development. I fully recognize its importance. But I think that we must have a better system. [Emphasis added.]

An ensuing colloquy between Senators Proxmire and McIntyre left no illusions but that only two possible controls on IR&D spending remained after the conference action; the advance agreement requirement for large contractors and the hope for a more thorough technical evaluation by DOD of contractors' IR&D proposals. The colloquy was as follows (116 CONG. REC., Part 26, at 34587–88):

MR. PROXMIRE. *Let me get a little further into the independent research. This was, in my view, gutted by the action of the conference committee.* The bill as it emerged from the Senate Armed Services Committee, and as it passed the Senate, established a ceiling of $625 million on independent research. That represented a reduction from 1969 when there was a $759 million expenditure on research and development. That was one distinct contribution to limit independent research and development.

In the second place, the Senate required the Defense Department to negotiate an advance agreement with independent contractors with respect to research and development.

Third was the attempt by the Senate to close loopholes whereby funds disallowed for one category could be used in another category.

It is correct that the conference committee eliminated the ceiling?

MR. MCINTYRE. The Senator is correct.

MR. PROXMIRE. Mr. President, is the Defense Department required to negotiate advanced agreements with contractors?

MR. MCINTYRE. *The Defense Department is required under the conference report to negotiate advanced agreements. The second part makes certain that the technical evaluation is performed. That is not a cursory matter as we have seen in the past, but is an intelligent searching*

through the brochures so that we will know as best we can what the particular company is doing on ongoing research.

MR. PROXMIRE, How about the capacity to shift funds from one category to another?

MR. MCINTYRE. Funds may be identified as I.R. & D. or B. & P., as appropriate but, under the language as agreed in conference, the category of OTE was eliminated.

MR. PROXMIRE. It was my understanding that the ceiling that the Senate adopted of $625 million was left out and no ceiling was included by the conference committee.

MR. MCINTYRE. That is correct.

MR. PROXMIRE. That was the ceiling we agreed on.

MR. MCINTYRE. That $625 million was overall. That is gone.

MR. PROXMIRE. It is my understanding that the $625 million referred to 50 large contractors.

MR. MCINTYRE. The Senator is correct.

MR. PROXMIRE. That is gone?

MR. MCINTYRE. That is gone, the overall ceiling.

MR. PROXMIRE. But there is a ceiling with respect to certain contractors. Which contractors are they?

MR. MCINTYRE. There is a ceiling to establish those contractors who are subject to advance agreements. It applies to those contractors who receive more than $2 million from DOD for independent research and development or bid and proposal.

MR. PROXMIRE. But there is no overall dollar ceiling. So, the Senate conferees gave in on the relevancy factor, leaving the judgment to the Secretary of Defense, and they eliminated the dollar ceiling on independent research and development.

MR. MCINTYRE. The Senator is correct.

MR. PROXMIRE. Mr. President, once again I pay tribute, as I have so often, to the Senator from New Hampshire. I think that he did a marvelous job in the committee and on the floor on this matter. However, *I am greatly disappointed and depressed that the conference committee did not stand hard and fast on this matter.*

It seems to me that we never get a satisfactory explanation, and neither does the public as to this enormous amount of money that the Federal Government pays every year for something vaguely called independent research and development. It has never been defined. We find that contractors are spending this money on various things that have not the slightest

reference to military expenditures. We find that we are spending some of it on strictly commercial activities.

What these people with the big corporations are doing is having the Federal Government provide the money to maintain a stable of engineers that they can use in any way they wish. It is very unfair when they are competing with other private firms that do not have the advantage of having a defense contract.

I am happy that the Senator from New Hampshire has assured us that he is not giving up and that he will attempt in the future to get a clear definition and have some definite understanding on the part of Congress as to what is done with the money of the taxpayers of this country.

MR. MCINTYRE. Mr. President, let me say to the Senator from Wisconsin, since the Senator brought this to the attention of the committee last year, I believe, that we feel even with the disappointment of having to abandon this and having it watered down, we are nevertheless on the right track.

The Department of Defense has admitted to some of their failings. They are hard at work trying to get the matter under control.

We got a feeling of mutuality from the House Committee when it came to technical evaluation.

Our committee will try to keep a sharp eye on it. We are making some progress along the lines that my friend, the Senator from Wisconsin, had hoped for when he brought this matter to our attention. [Emphasis added.]

* * * * *

The Senate agreed to the conference report on October 1, 1970, (116 CONG. REC., Part 26, at 34601) and 1 week later the President signed H. R. 17123 into law as Pub. L. No. 91–441.

The materials detailed above comprising, so far as research has disclosed, all relevant indicia of Congress' aim in adopting the provision in issue, convincingly demonstrates that the principle of cost sharing was not intended to play any part in ascertainment of the dollar ceilings to be negotiated for purposes of mandatory advance agreements limiting contractor reimbursements for IR&D costs. However appealing, as a matter of policy, the utilization of cost sharing as a rational and effective deterrent to overreaching by large contractors in their conception and implementation of IR&D programs, the plain fact is that no

one in the Congress, including Senator Proxmire, the most staunch advocate of the necessity to curtail contractor abuse, affirmatively endorsed cost sharing as an appropriate or desirable instrument for control. As the prime mover of both the legislation here involved and its immediate predecessor, Pub. L. No. 91–121, Senator Proxmire never deviated from his repeatedly announced thesis that the two basic flaws in the IR&D programs administered by DOD were; first, the absence of any upper limit on the amount of funds that it could disburse annually to the contractor community at large for such purposes; and second, the lack of any real assurance that the IR&D work subsidized by DOD actually related to defense procurement objectives as opposed to the development of civilian business. In the latter connection, he never suggested that a contractor should be made to bear any part of the costs incurred by him for IR&D that in fact pertained to the defense effort. Indeed, as revealed by his floor colloquy with Senator Symington, *supra*, he expressly disclaimed any such intention. In the instant case, however, the defendant's position is precisely that it could require AESC to enter into an advance agreement embodying a dollar ceiling on reimbursement ($950,000) that was purposely depressed as a means of requiring plaintiff to absorb the excess portion of $1,084,438.57 in IR&D costs that were concededly reasonable in amount, allocable to DOD contracts and therefore incurred by it "* * * for projects that had a potential relationship to a military function or operation." Findings 14, 16. Despite his obvious good faith and the persuasive logic of his position, when considered as an original proposition, the contracting officer's insistence on plaintiff's sharing of any part of those costs was simply unwarranted by the direct language and discernible intent of Pub. L. No. 91–441, the criterion by which the validity of his actions must be gauged. However great the temptation, it must be remembered that it is not the function of a court to engraft on a statute additions which it thinks the legislature might or should have made. *United States* v. *Cooper Corp.*, 312 U.S. 600, 605 (1941).

Accordingly, on the undisputed facts of record in this proceeding plaintiff must prevail as a matter of law.

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CONCLUSION OF LAW

Upon the foregoing opinion and the findings of fact which are made part of the judgment herein, the court concludes as a matter of law that plaintiff is entitled to recover and judgment is therefore entered for plaintiff in the amount of three hundred sixty-eight thousand, nine hundred sixty-three dollars and sixteen cents ($368,963.16).

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566 F.2d 1146

JOSEPH M. EURELL v. THE UNITED STATES

[No. 249–76. Decided December 14, 1977]

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

Military pay; discharge for physical disability; correction of naval records; limitation of actions; continuing claim theory; laches.— On December 29, 1969, after proceedings before a Medical Board and a Physical Evaluation Board, but without plaintiff's personal appearance before either, plaintiff was discharged from the Marine Corps (with service of about a year) on the ground of a physical disability existing prior to service. In 1970 plaintiff applied to the Board for Correction of Naval Records for correction of his records to show retirement for physical disability; in 1971 the Board corrected his records to show discharge with severance pay and a physical disability rating of 10% effective December 29, 1969. A second application for relief was denied by the Board May 6, 1976 without findings. Plaintiff's petition filed here on June 21, 1976 alleges that the determinations of the Medical and Physical Evaluation Boards were incorrect because there were various stated procedural defects and improprieties in the proceedings before those Boards; these allegations were not made when plaintiff applied to the Correction Board in 1970. It is *held* (1) that plaintiff's claim is barred by the statute of limitations; (2) that the claim is not a "continuing claim"; (3) that the "half-a-loaf" doctrine does not apply on the basis of the action taken by the first Correction Board since the appropriate monetary relief and correction of plaintiff's records were then granted in accordance with the presentation made by plaintiff at that time; and (4) that plaintiff's claim is also barred by laches, particularly in view of the prejudice to defendant resulting from the long delay in filing suit in this court. Defendant's motion for summary

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judgment is granted, plaintiff's cross-motion is denied, and the petition is dismissed.

Military pay; limitation of actions; accrual of cause of action; retired pay (disability).

[1] A claim for disability retired pay accrues upon denial by a Physical Evaluation Board; under 28 U.S.C. § 2501 suit must be filed within 6 years of the time the claim first accrues.

Armed Services ⚖23.5

Military pay; limitation of actions; tolling of statute of limitations; Correction Board proceedings.

[2] Post-discharge remedies, such as proceedings before the Board for Correction of Records, are permissive administrative procedures and do not toll the statute of limitations.

Armed Services ⚖23.5

Military pay; retired pay (disability); Physical Disability Review Board; hearing, right to.

[3] 10 U.S.C. § 1214 which accords a member of the Armed Forces the right to a hearing before a retiring or physical evaluation board if it is demanded, does not of itself create a statutory right to periodic disability retirement payments which would fall within the "continuing claim" doctrine. Insistence on a full and fair hearing under Sec. 1214 is part and parcel of a claim barred under 28 U.S.C. § 2501.

Armed Services ⚖23.5

Military pay; limitation of actions; continuing claim theory; when applicable.

[4] A continuing claim does not necessarily arise merely because the Correction Board denied a member of the Armed Forces all the relief he may have desired in his original petition. Where plaintiff requested the Board to correct his records to show entitlement to disability retirement pay, and the Board granted appropriate monetary relief (severance pay) for the correction it made in plaintiff's records (a 10% disability rating), the "half-a-loaf" doctrine does not apply to plaintiff's current and new allegations of procedural deficiencies and improprieties respecting proceedings before the Medical and Physical Evaluation Boards. The limitations period cannot be extended to cover such newly raised allegations.

Armed Services ⚖23.5

Military pay; laches.

[5] Laches is applicable to military pay and disability retirement pay cases. Passage of time alone is ordinarily not adequate to sustain the bar of laches; prejudice to the defendant must be shown. The greater the lapse of time, the less need there is to show specific prejudice.

Armed Services ⚖23.5

Military pay; limitation of actions; accrual of cause of action; retired pay (disability); final action by proper board.

[6] A simple affirmation by the Correction Board without findings of its prior decision denying without a hearing plaintiff's application for

Per Curiam

disability retirement pay based on a recommendation of the Bureau of Medicine and Surgery, does not give rise to a cause of action for alleged arbitrary action by the second board where the claim before the court for disability retirement pay is barred by limitations and laches.

Armed Services ⚖23.5

Richard P. Fox, attorney of record, for plaintiff. *Richard P. Fox & Max Gest*, of counsel.

LeRoy Southmayd, Jr., with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant. *Lieutenant Scott K. Walker*, JAGC USNR, of counsel.

Before DAVIS, KUNZIG, and BENNETT, *Judges*.

PER CURIAM: This military disability retirement pay case is before the court on cross-motions for summary judgment; oral argument has been waived. On December 29, 1969, the plaintiff, after proceedings before a Medical Board and a Physical Evaluation Board, was discharged from the Marine Corps (with service of about a year) on the ground of a physical disability which existed prior to service. He was awarded neither severance pay nor retirement pay. The plaintiff has twice sought relief from the Board for Correction of Naval Records (BCNR), seeking compensable disability retirement. In response to his first application dated December 3, 1970, the BCNR corrected his records (in 1971) to show a discharge with severance pay and a physical disability rating of 10% effective December 29, 1969;[1] no relief was granted on his second application dated May 6, 1976. The plaintiff filed his petition in the instant case on June 21, 1976. He alleges that the determinations of the Medical Board and the Physical Evaluation Board were incorrect and that, above all, there were various procedural defects and improprieties in the proceedings before those boards, including, *inter alia*, that because of his civilian attorney's disloyalty plaintiff, although he desired to make a personal appearance, did not appear before the Medical Board and that he was coerced into waiving his right to appear before the

[1] A rating of 10% is insufficient for disability retirement pay which plaintiff sought.

Physical Evaluation Board by the same civilian attorney hired by the government to act on his behalf and a Navy Lieutenant Commander, who told him that he would be recalled to Viet Nam if he did not waive his right to appear before the Physical Evaluation Board. We grant the defendant's motion for summary judgment and deny plaintiff's motion.

First, the plaintiff's claim is barred by the statute of limitations. It has long been settled that the cause of action accrued at the time of the plaintiff's discharge from the service. *See, e.g., Bruno v. United States*, 214 Ct. Cl. 383, 388, 556 F.2d 1104, 1107 (1977). Suit must be filed within six years of the time the claim first accrues. 28 U.S.C. § 2501 (1970). The running of limitations was not tolled by the plaintiff's petitioning the BCNR since resort to permissive administrative procedures does not toll the statute. *See, e.g., Bruno, supra*, 214 Ct. Cl. at 386,556 F.2d at 1106; *Brundage v. United States*, 205 Ct. Cl. 502, 507, 504 F.2d 1382, 1385 (1974) *cert. denied*, 421 U.S. 998 (1975).

The plaintiff asserts, however, that a continuing claim arose at the time (1971) the BCNR granted partial relief instead of complete relief, and that the instant case therefore falls under the "half-a-loaf" doctrine.[2] *DeBow v. United States*, 193 Ct. Cl. 499, 434 F.2d 1333 (1970), *cert. denied*, 404 U.S. 846 (1971). The defendant responds that the "half-a-loaf" doctrine is not applicable to this plaintiff, because in his 1970 petition to the BCNR he did not raise

[2] The plaintiff also argues that his claim to a full and fair hearing under 10 U.S.C. § 1214 (1970) on his disability separation is a statutory right dependent on his military record and the law, and independent of the action of any board or agency, and is therefore a continuing claim under the principle of *Bruno, supra*, 214 Ct. Cl. at 387, 556 F.2d at 1106, and *Gordon v. United States*, 134 Ct. Cl. 840, 844, 140 F. Supp. 263, 265 (1956). However, as *Gordon, supra*, makes clear, the claim in that case was a statutory right to periodic payments, and a new claim accrued each pay period. 10 U.S.C. § 1214 (1970) does not of itself create a statutory right to periodic payments which would fall within the "continuing claim" doctrine. The reliance on § 1214 goes only to plaintiff's claim that he should have been granted disability retirement pay, a claim which we have many times held accrues all at once upon denial by a Physical Evaluation Board. *See Friedman v. United States*, 159 Ct. Cl. 1, 25, 310 F.2d 381, 396 (1962), *cert. denied sub nom. Lipp v. United States*, 373 U.S. 932 (1963). Therefore, the plaintiff's insistence on a full and fair hearing under 10 U.S.C. § 1214 (1970) is part and parcel of a claim barred under the statute of limitations, and there is no need in this case to reach the question whether this court has jurisdiction under *United States* v. *Testan*, 424 U.S. 392 (1976), over a claim founded on § 1214.

any issues about the actions of his counsel or the administrative procedures of the Medical Board and the Physical Evaluation Board prior to his discharge; all that the plaintiff requested in his 1970 petition was an increase of his disability rating. The defendant likens the present situation to several cases in which the plaintiffs sought correction of their military records while expressly disavowing certain relief; subsequently, they brought suit in this court seeking the additional relief they had previously disavowed in the prior proceedings. This court refused to allow them to use the favorable results obtained in the prior proceedings (in the course of which they disavowed particular relief) as a springboard for avoiding the bar of the statute of limitations on the very claims they had previously rejected. *Denton v. United States*, 204 Ct. Cl. 188, 198 (1974), *cert. denied*, 421 U.S. 963 (1975); *DeBow v. United States, supra*, 193 Ct. Cl. at 503–04, 434 F.2d at 1335; *accord, Homcy v. United States*, 210 Ct. Cl. 332, 337–39, 536 F.2d 360, 364–65, *cert. denied*, 429 U.S. 984 (1976).

Although we agree that the plaintiff may not avail himself of the "half-a-loaf" doctrine, it cannot be fairly said that he expressly renounced any ground of relief in prior petitions to the BCNR. In his 1970 application he wanted to be "rated or retired" because his prior diagnosis by the Navy was incorrect; in his second petition he asked to be placed on the temporary disability retired list or "permanently retired" or alternatively to be granted an appearance before the Physical Evaluation Board, which had been "unjustly" denied him. Although the plaintiff has presented new issues in regard to being afforded his right to appear before a Physical Evaluation Board, they would appear to be raised as a means towards obtaining disability retirement pay, which was requested in his initial application to the BCNR. However, a continuing claim does not necessarily arise merely because the BCNR denied the plaintiff all the relief he may have desired in his original petition.[3]

[3] As we have pointed out, the plaintiff was in fact granted a 10% disability rating with severance pay.

As *Homcy, supra,* 210 Ct. Cl. at 337–38, 536 F.2d at 364, points out, the "half-a-loaf" doctrine normally applies to those cases in which the administrative body decides that the claimant should prevail on a certain claim and that relief is appropriate, but it arbitrarily awards less than the full appropriate relief (when requested by the plaintiff) for the claim it recognizes. Once an administrative body has made a decision that relief is proper, then it has a duty to grant "thorough and fitting relief." *Sanders v. United States,* 207 Ct. Cl. 962, 963 (1975); *Homcy, supra.* In some instances, the award of the appropriate monetary relief may become mandatory. *See Ray v. United States,* 197 Ct. Cl. 1, 453 F.2d 754 (1972) (plaintiff entitled to return of withholding payments on his retirement pay after his records were corrected to show retirement for disability instead of longevity). At that point, a plaintiff may have a claim that is no longer dependent upon administrative determination, and, if it is a claim to periodic payments, it may fall within the "continuing claim" doctrine. *See Barnes v. United States,* 163 Ct. Cl. 321, 328 (1963). This court explained the doctrine in *Denton, supra,* 204 Ct. Cl. at 195–96, as follows:

> We held in *DeBow* that a major reason for allowing a cause of action to be based on an initial favorable administrative determination, that would otherwise be barred by limitations, is that once an administrative body decides relief is proper on the claim and presentation then made, it should not be free to illegally or arbitrarily award less relief than that requested by the claimant in that proceeding. In the context of the correction of a military record, this means that once a discretionary decision is made to correct a record, the grant of appropriate money relief is not discretionary but automatic. *Ray v. United States,* 197 Ct. Cl. 1, 453 F.2d 754 (1972). If appropriate payment is not then made, a cause of action accrues in this court at that time. *Ray, supra.* In this case, however, the appropriate payment has been made and plaintiff seeks only a new discretionary correction of his record. In these circumstances, the 1966 record correction is a nullity so far as concerns the accrual of a cause of action and whatever cause plaintiff has accrued in 1964 or earlier, and is now time barred.

Although the plaintiff in the instant case has not renounced any right to disability retirement pay, the BCNR did grant the appropriate monetary relief, severance pay, for the correction it made in the plaintiff's records, *i.e.*, a 10% disability rating. 10 U.S.C. § 1203 (1970). Since the appropriate payment was evidently made at that time, it can be said that no other claim, continuing or otherwise, may be made under the "half-loaf" theory on the basis of the action the BCNR took in 1971; the plaintiff received, not a "half-loaf," but a "full loaf" for the correction then made. Moreover, even if the "half-loaf" principle is viewed somewhat more broadly, it would not be proper to use the 1971 BCNR determination to extend the limitations period so that the court may now consider factual issues which the claimant did not suggest in any form to the Correction Board in 1970–71. Our opinions discussing the prolongation of the limitations span as a result of a board decision have stressed the duty of the administrative tribunal, if it grants some relief, to award all the relief required by the presentation then made. *See Homcy, supra,* 210 Ct. Cl. at 338, 536 F.2d at 364; *Denton, supra,* 204 Ct. Cl. at 195, 198; *DeBow, supra,* 193 Ct. Cl. at 503, 434 F.2d at 1335. Here, plaintiff did not tell the 1971 BCNR about the procedural deficiencies he now asserts, and that board could not have been expected to consider them or to award relief on those grounds. It follows that that board cannot be said to have acted "illegally or arbitrarily" (*Denton, supra,* 204 Ct. Cl. at 195) when it failed to take account of the alleged defects plaintiff now puts forward, and there is no reason to extend or prolong the limitations period to cover the current allegations.[4]

Alternatively, we hold that, even if the limitations bar has not fallen, plaintiff is barred by laches, which is applicable to military pay and disability retirement pay cases. *Devine v. United States,* 208 Ct. Cl. 998, 999 (1975); *Sharp v. United States,* 207 Ct. Cl. 975, 976 (1975); *Brundage v. United States, supra,* 205 Ct. Cl. at 507, 504 F.2d at 1385. This court is reluctant to apply the doctrine

[4] There is likewise nothing to show that the 1971 BCNR acted arbitrarily or illegally on the presentation then made, when it decided that the degree of plaintiff's disability attributable to his military service did not exceed 10%.

when a plaintiff has diligently pursued permissive administrative remedies such as the BCNR. *Steuer v. United States*, 207 Ct. Cl. 282, 295 (1975); *Cason v. United States*, 200 Ct. Cl. 424, 432, 471 F.2d 1225, 1229–30 (1973). However, over four years elapsed between the date of the first decision of the BCNR, October 7, 1971, and the plaintiff's second application there, May 6, 1976, while over six years passed from the time of plaintiff's discharge in 1969 until the filing of the petition in this case in June 1976. There were almost five years between the first BCNR decision—when the claim first accrued according to plaintiff's argument—and the filing of suit in this court. A record of that type does not present any compelling reason against the application of the laches doctrine.

The mere passage of time alone is ordinarily not adequate to sustain the bar of laches; prejudice to the defendant must be shown, but the greater the lapse of time, the less need there is to show specific prejudice. *Devine, supra*, 208 Ct. Cl. at 1001; *Brundage, supra*, 205 Ct. Cl. at 509, 504 F.2d at 1386. The defendant not only contends that the recollections of the doctors and civilian attorneys associated with the plaintiff's 1969 discharge would undoubtedly have faded, but it has also submitted an affidavit that it has been unable to locate the two attorneys, notwithstanding inquiries to the New York State Bar Association and a search of New York City telephone directories, the Martindale-Hubbell Law Directory for New York State, and the computer records of the Information Systems Development and Support Branch, Office of Civilian Personnel, Department of the Navy. In addition, the United States Naval Hospital, St. Albans, New York, at which the plaintiff was a patient, no longer exists, and the defendant has no list of employees associated with that hospital in a legal capacity. In plaintiff's presentation to us these attorneys played a significant role in depriving him of his procedural rights. It is unfair in such circumstances to expect the Government to be able to defend against plaintiff's charges of improper conduct on the part of the Medical Board, the Physical Evaluation Board, and the attorneys appointed to represent him. *See Brundage, supra*, 205 Ct. Cl. at 510–12, 504 F.2d at 1387–88. The combination

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of this specific prejudice plus the long delay in filing suit is enough to invoke laches here.[5]

The defendant's motion for summary judgment is granted, plaintiff's motion for summary judgment is denied, and plaintiff's petition is dismissed.

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568 F.2d 695

THE SINGER COMPANY, LIBRASCOPE DIVISION v. THE UNITED STATES

[No. 132–75. Decided December 14, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; disputes; changes; substantial evidence; acceptance of or assent to contractual undertaking; interest on borrowings; claim preparation costs.—Plaintiff (Librascope) entered into a contract for the design and fabrication of a data processing subsystem which was to form the computer nucleus of a world-wide Air Force information gathering, recording and dispensing system. The original contract covered an interim operational capability configuration of the data processing subsystem constituting one-half of a proposed paired system which, in its entirety, was to be referred to as the Complete Operational

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[5] The plaintiff also asserts that the letter from the BCNR to the plaintiff denying him any relief under his 1976 application failed to meet the requirements of *Craft v. United States*, 210 Ct. Cl. 170, 544 F.2d 468 (1976), which the plaintiff cites as standing for the proposition that an administrative board, in considering a medical claim, must present reasons for its decision rather than deny the applications in conclusory terms. However, *Craft, supra*, dealt with a Physical Review Council which overturned a Physical Evaluation Board's determination that the plaintiff was fit for duty. The applicable regulations allowed such a reversal only under specified conditions and required a summary of the reasons for the action. In that situation, the failure of the Council to specify its reasons for overturning the determination of the Physical Evaluation Board compelled the court to search the record, and it was unable to find any basis specified under the regulations for sustaining the Council's reversal of the Physical Evaluation Board. In the instant case, the BCNR merely affirmed its prior decision in 1971, which was based on a recommendation of the Bureau of Medicine and Surgery. 32 C.F.R. § 723.3(e)(3) (1976) does not require any written findings or decision when an application is denied by the BCNR without a hearing, and no hearing appears to have been held in 1976. Moreover, even if it were to be assumed that the BCNR acted arbitrarily in denying the plaintiff any relief under his second application, this would not give rise to a cause of action in his favor for disability retirement pay if, as we have held, that claim is barred by limitations and laches. *See Friedman v. United States, supra*, 159 Ct. Cl. at 21, 310 F.2d at 394. The action of the 1976 board would not create a "new" claim.

Syllabus

Capability configuration. The Government retained and eventually exercised its option to order the complete system. Contending that during contract performance, the Government had ordered work beyond that required by the contract, plaintiff sought administratively additional compensation under the Changes clause of the contract. Plaintiff also sought reimbursement of interest costs on borrowings and claim presentation costs. The contracting officer denied the claims, and on appeal the Contract Appeals Board allowed the appeal in part and, after rehearing, awarded plaintiff $479,641 (less than the amount claimed). On plaintiff's petition for review under Wunderlich Act criteria, the trial judge in a recommended decision affirmed the Board's decisions as based on substantial evidence. Plaintiff has excepted to the trial judge's recommended decision respecting only claims relating to: the requirement for a report setting forth reliability predictions for the equipment (claim 9); the requirement to improve the reliability of the magnetic tapes (claim 3.c); the requirement to prepare a Category I test plan (claim 10.d); and reimbursement of interest costs on borrowings (claim 11). Oral argument was confined by both parties to claim 11. It is *held* that the Board decision was supported by substantial evidence, was not arbitrary or capricious and was not contrary to law. It is also *held* that under the circumstances of this case plaintiff is not entitled to reimbursement of its costs of borrowing money to finance the added work required by the constructive change orders and for which the Board allowed an adjustment. Plaintiff is not entitled to recover and the petition is dismissed.

Interest; claims against United States; interest on borrowings; debt v. equity capital.

[1] 28 U.S.C. § 2516(a) prohibits this court from awarding interest on a claim except where allowed by contract or where authorized by statute. In view of the insufficiency of the showing before the Contract Appeals Board as to plaintiff's and its parent's actual debt policy, how its debt structure was made up in the relevant period, and what connection extra work on constructive changes might have with that structure, the court will not take judicial notice of this essential evidence to support plaintiff's claim to entitlement of costs of borrowing money to finance added work required by the constructive change orders on which an adjustment was administratively allowed. Notwithstanding the alleged decisional trend by the Contract Appeals Board to allow interest as an element of profit based upon the imputed value of the equity capital, absent the said essential evidence the lack of a nexus or causal connection between plaintiff's expenditures and the borrowings by its parent to finance the extra work bars allowance of the claim.

Evidence ⇐22(1)
United States ⇐110

Contracts; formation of contract; acceptance or assent.

[2] Manifestations of assent that are in themselves sufficient to conclude a contract will not inhibit such effect merely because the

Per Curiam

parties may also have manifested an intention to prepare and adopt a later written memorial of their agreement.

United States ⚖66

Contracts; damages; measure of damages; legal fees, etc.; cost of preparing and prosecuting claim.

[3] Costs incurred in preparing and prosecuting a claim for an equitable adjustment administratively, such as legal fees, consultants' fees and in-house personnel costs, are not recoverable, where such costs were not incidental to performance of the work or alleged changes and they bore no beneficial nexus either to contract production or contract administration. *Allied Materials & Equip. Co.*, ASBCA No. 17318, 75-1 BCA ¶ 11,150, *distinguished.*

United States ⚖70(21)

Herbert L. Fenster, for plaintiff. *Gilbert A. Cuneo*, attorney of record. *Steven L. Briggerman* and *Sellers, Conner & Cuneo*, of counsel.

R. W. Koskinen, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before LARAMORE, *Senior Judge*, NICHOLS and KASHIWA, *Judges*.

PER CURIAM: This case under the Wunderlich Act, 41 U.S.C. §§ 321, 322, comes before the court on cross-motions for summary judgment, and on the plaintiff's request for review of a report and recommended decision by Trial Judge John P. Wiese, filed by him pursuant to Rule 166(c), and affirming a decision of the Armed Services Board of Contract Appeals (ASBCA). It has been submitted on the briefs and oral argument of counsel.

Plaintiff excepted only to the trial judge's recommended dispositions respecting Claim Items 9, 3.c, 10.d, and 11, and has offered no opposition to the recommendations of the trial judge on other items. Before us, oral argument was confined by both sides to Item 11.

Upon consideration thereof, the court agrees with the trial judge's recommended decision respecting all claim items, and hereby affirms and adopts the same as the basis for its judgment in the case.

Item 11 demands that the equitable adjustment for changes should incorporate an allowance for the cost of

borrowing money to finance added work required by the constructive change orders on which such adjustment was allowed by the ASBCA, the amount thereof, absent interest, being $479,641. The Board denied this item as does the trial judge and as do we, but the trial judge alters the Board's grounds somewhat. He takes the view in substance that the evidence before the Board, read most favorably to plaintiff, fails to establish a nexus or causal connection between the expenditures by plaintiff and the borrowings by plaintiff's corporate parent to provide cash for all its activities and those of its subsidiaries. He refers to a decisional trend by the ASBCA to allow interest not actually paid as such, "as an element of profit based upon the imputed value of the equity capital." Plaintiff before us argued that the full scope of this new doctrine would make the nexus evidence found missing by the trial judge wholly irrelevant. But the case was not presented to the Board on any such theory, and the issue is not without its difficulties for us in view of the ancient doctrine disallowing interest against the Government, in the absence of express statute or contractual provision. *E.g., Mescalero Apache Tribe* v. *United States*, 207 Ct. Cl. 369, 518 F.2d 1309 (1975), *cert. denied*, 425 U.S. 911 (1976). Our decision here rests solely on the insufficiency of the showing before the Board as to plaintiff's and plaintiff's parent's actual debt policy, how its debt structure was made up in the relevant period, and what connection extra work on constructive changes might have with that structure, all of which were things we could not judicially know and were essential to support Item 11 on the theory on which it was actually prosecuted. Nothing said or done in this case should be taken as intimating how interest or imputed interest should in general be dealt with in computation of equitable adjustments, where a contractor has financed additional work without contemporary reimbursement for it, nor what proof should be requisite to sustain a claim of that sort. This case stands on its own peculiar history. We note, however, that in a decision contemporaneous with this, another panel of this court grapples with the problem and establishes a precedent with respect to it. *Framlau*

Corp. v. *United States*, *ante* at 185.

It is, therefore, concluded that the Board decision was supported by substantial evidence, was not arbitrary or capricious, and was not contrary to law. The plaintiff is not entitled to recover, and its motion for summary judgment is denied. The defendant's motion for summary judgment is granted and the petition is dismissed.

OPINION OF TRIAL JUDGE

WIESE, *Trial Judge:* In a contract with defendant dated May 3, 1962, plaintiff (also referred to herein as Librascope or the contractor) agreed to design and fabricate a Data Processing Subsystem which was to form the computer nucleus of a world-wide Air Force information gathering, recording and dispensing system—a logistics management tool to be known as the 473–L System. Plaintiff has alleged that in the performance of this contract, the Government ordered work beyond that required by the terms of the agreement, the costs of which are claimed to be compensable under the Changes clause of the contract. Following an unsuccessful presentation of its claims to the contracting officer, plaintiff appealed to the Armed Services Board of Contract Appeals,[1] requesting that it be compensated in the amount of $3,918,000 on account of the alleged changes. The appeal was allowed in part and denied in part by the Board, which after reconsideration,[2] awarded the contractor the sum of $479,641. Relying now on both sections of the Wunderlich Act,[3] plaintiff appeals to this court certain of the claims that were denied by the Board. We affirm the Board's denial of these claims.

I. Facts

The contract for the Data Processing Subsystem portion of the 473–L System resulted from a two-step advertised

[1] *Singer-General Precision, Inc., Librascope Group*, ASBCA No. 13241, 73–2 BCA ¶ 10,258.

[2] *Singer-General Precision, Inc., Librascope Group*, ASBCA No. 13241 (June 5, 1974) (unpublished).

[3] 41 U.S.C. §§ 321–22 (1970).

procurement procedure. The proposal that plaintiff submitted in response to the Government's request for technical proposals was incorporated into the contract. The original contract covered only what was termed the Interim Operational Capability (IOC) configuration of the Data Processing Subsystem, that is, one-half of a proposed paired system which, in its entirety, was to be referred to as the Complete Operational Capability (COC) configuration. The Government retained and eventually exercised its option to order the complete system.

Librascope had previously provided a computer system to the Federal Aviation Administration (FAA) which it believed to be similar to the Government's contemplated 473–L System. Accordingly, in the instant situation, Librascope's proposal envisioned use of this FAA computer as a baseline from which to develop the subsystem for the 473–L program. Also, that proposal relied significantly on the use of off-the-shelf components, a practice which was encouraged by the Air Force.

The 473–L System was made up of three major hardware components: the Data Processing Subsystem (DPSS) which was to receive, process, store and dispense information received from other components of the system, the AUTODIN which was an existing world-wide Air Force communications network, and the Integrated Console Subsystem (ICSS) which was to be used to display information received from the Data Processing Subsystem. It was understood by all parties that a crucial aspect of contract performance would involve successful integration of these three major elements.

A number of other contractors were involved in the development of the 473–L System as a whole. In addition to contractors that supplied hardware elements, there were those that provided software and others who advised the Government on different technical aspects of the system. The Data Processing Subsystem was the first part of the 473–L System to be procured, although considerable work had previously been done by the Government (as well as other contractors) in preparation for the work of the Data Processing Subsystem contractor.

Given its scope and complexity, effective administration of the procurement demanded the participation of several Government agencies and private contractors. Thus, overall responsibility (*i.e.*, the contracting officer) was located in the System Program Office of the Electronics Systems Division (ESD) of the Air Force Systems Command; Rome Air Development Center (RADC), another command in the Air Force, was assigned responsibility for providing technical engineering consultation to the 473–L Engineering Division at the Electronics Systems Division (ESD); MITRE Corporation (MITRE), a nonprofit organization, provided technical assistance in electronics design to the System Program Office; International Business Machines Corporation (IBM) was placed under contract to provide technical assistance to the Electronics Systems Division; finally, International Telephone and Telegraph Corporation (ITT) was contractually responsible for the Integrated Console Subsystem portion of the 473–L System.

The Data Processing Subsystem contract was essentially completed in the fall of 1964, more than a year later than scheduled. Additional facts are provided as part of the discussion of each of the several claims that follow.

II. The Contractor's Claims[4]

Claim 6.e
Elimination of Duplexer

In plaintiff's original technical proposal of February 19, 1962, the COC installation (that is, the total paired system) that was depicted included, as a part of the Data Processing Subsystem, a freestanding piece of equipment referred to as a duplexer. The purpose of the duplexer was to provide the COC configuration with a switching capability that would permit either of the two central processing units to function with either of the two mass memory units. In the COC equipment, as finally installed, a freestanding duplexer was not included. Plaintiff's claim is that elimination of the duplexer had been unilaterally ordered by the Government and that, because of this action, it became necessary

[4] For the sake of consistency, the contractor's claims are identified in this opinion by the same claim numbers that were used in the proceedings before the Board.

to substitute a more complex (and more expensive) distributed switching system. Recovery of the additional costs associated with this claimed extra effort was denied by the Board on the ground "that the change was not directed by any official of the Government authorized to do so." (73–2 BCA at 48,385.) The Board's decision is correct.

In the development of its proof at trial, plaintiff offered no direct evidence—either in the form of documentation or oral testimony—to support the contention that the Government had ordered the elimination of the duplexer. Those of its witnesses who spoke on this subject testified only to the fact of the change but they were without firsthand knowledge as to the reasons for that change. Significantly, the very individual who had been identified as the recipient of the Government's change order—plaintiff's technical director—was never questioned on this point even though he was available at the hearing and had testified to other contract matters during the course of the hearing.

The point is pressed now that the Board's decision was wrong because it ignored the testimony adduced during the cross-examination of the acting director of the Government's System Program Office. The question had been put to this witness whether he had informed plaintiff's technical director that the duplexer would not meet the contract requirement because it was a unique piece of equipment. The answer that was given was: "This is probably so. Device and not function, again I differentiate." It is this answer which plaintiff's brief identifies as a Government "rejection" which forced plaintiff to redesign the system to eliminate the freestanding duplexer.

The distinction that was drawn by the witness between uniqueness in device and uniqueness in function is a differentiation that draws upon two separate contract provisions. Functional uniqueness was prohibited by virtue of that requirement in the specifications which stated that "[n]o set of equipment that is used to satisfy these [major] functional areas [*i.e.*, data processing, input/output and storage] shall be unique in the 473L system so that its failure would cause complete failure of the entire 473L system." To satisfy this prohibition, the equipment had to

have a "multi-thread" capability, meaning, that it had either to be internally duplicated (parallel capabilities within the same housing) or to be externally duplicated (paired with a like piece of equipment). Uniqueness of device, on the other hand, has reference to that provision in the contractor's technical proposal which, in describing the intended multi-thread design, said that "[n]o single item of equipment is unique to the complete duplexed system." In other words, in achieving the multi-thread capability, a design constraint was the requirement that the COC system reflect a paired identity of IOC systems. The two IOC systems were to be mirror images of each other and together they would constitute the COC system.

It is not clear from plaintiff's briefs whether it views the Government's alleged rejection of the duplexer as one stemming, in the first instance, from the basic requirement for functional redundancy (i.e., the need for multi-thread capability) or from the subordinate provision that the COC system should comprise two essentially identical IOC systems. What is clear, however, is that neither argument can prevail.

As to the first of these arguments, the testimony leaves no room for doubt concerning the Government's position. The duplexer was internally "duplexed," meaning that, as built, it was functionally redundant and therefore satisfied the basic requirement of multi-thread capability. There is no question that the Government understood this. The same witness upon whose testimony plaintiff now attempts to rely said unequivocally that "[t]he duplexer, freestanding or otherwise, provided the function that met the requirements of contract."

At the same time, however, the duplexer was essential only to the COC configuration and, in this sense then, it was "unique"—it was not a piece of equipment common to both the IOC and COC configurations. This too the Government's witness recognized; thus, his answer on cross-examination: The duplexer was unique in "[d]evice and not function, again I differentiate."

But, to have identified the duplexer as a unique device falls considerably short of saying that the Government had demanded its elimination. The testimony, in fact, is

otherwise. The witness stated that "Librascope of their own volition chose to incorporate those functions [of the duplexer] in the main frames in more strict compliance with some numerical aspects of the contract that two times IOC equals COC." That self-directed incorporation, which the witness further identified as "a legitimate design choice on the part of Librascope," was never convincingly contradicted by any of plaintiff's direct proof. Thus, in the final analysis, what plaintiff would now have us do is read into the record a conclusion that it involuntarily abandoned the initially planned use of a freestanding duplexer because the Government had condemned it for being a unique piece of equipment.

The approach is futile. To begin with, it is far from clear that the uniqueness of the duplexer was ever a matter of more than passing comment on the part of the Government. The Government witness readily conceded, for example, that aside from the duplexer, there probably were other unique pieces in the COC equipment. And this he referred to as a "transient consideration"—an unavoidable condition resulting from the fact that the IOC and COC configurations had represented separate procurements entered into at two different points in time. The duplexer fit this situation—it was a link between the two halves of the COC configuration.

Furthermore, even if we read the testimony on which plaintiff relies as indicative of some sterner measure of Government disapproval, it is still not enough to say that the Government *directed* plaintiff to take the step it did. Had there been such a directive one could reasonably have expected to see, as part of the proof offered in this case, some contemporaneous evidence of the position that plaintiff now asserts, namely, that the duplexer was not among those items of equipment subject to the uniqueness prohibition—in other words, some evidence of protest. However, proof of that sort was never offered. On the record before it, the Board reached the correct result.

Claims 1.b and 6.a
Change from Fixed to Variable Pairing of Buffer Processors

Plaintiff's original design for the COC configuration, which was incorporated into the contract, included ten L–119 Buffer Processors (L–119s)—small digital computers used to provide necessary changes in the transmission rate of information traveling between the subsystems. Eight of these ten L–119s were located between the two central processing units of the Data Processing Subsystem and the AUTODIN, that is, four L–119 buffer processors were physically and functionally attached to each of the two central processing units in the COC configuration.[5] Each such set of four included two L–119s which could send messages from the central processing unit to the AUTODIN and two L–119s which could receive messages for the central processing unit from AUTODIN. Thus, each central processing unit had two send-receive pairs; one was designed to act as a back-up for the other in order to provide the "multi-thread" capability required by the contract.[6]

This aspect of plaintiff's design underwent change early in the relationship between the parties. The initial configuration of eight L–119s in the DPSS/AUTODIN interface was retained in plaintiff's written description of the Data Processing Subsystem dated April 1962 (the April Subsystem Description) which had been submitted to the Government before the contract was signed. However, in the August 1962 Subsystem Description, transmitted to the Government after contract signing, there were shown only four L–119s in the DPSS/AUTODIN interface—one send-receive pair for each central processing unit rather than the two pair as had initially been proposed. There is no dispute that this was the first time that defendant was

[5] Two of the ten L–119s are not relevant to this claim.

[6] Plaintiff's witness testified at the hearing that the original design, *i.e.*, four pairs of L–119s in the DPSS/AUTODIN interface, with two of them acting as backup devices for the other two, was developed in response to the requirement for multi-thread capability.

made aware of plaintiff's intention to reduce the originally planned number of L–119s.

The contractor's August Subsystem Description, as well as each of its previous program descriptions, had indicated Librascope's intention to create a fixed link between the send-receive pairs of L–119s, that is, that each "send" L–119 would be able to operate with only one certain "receive" L–119. However, as a result of a meeting that took place between the parties on November 7–8, 1962, plaintiff changed its design to permit variable pairing of the four remaining L–119s so that each of the two "send" L–119s could be paired with either of the two "receive" L–119s.

Librascope has claimed that at the November 7–8 meeting, the Government unilaterally ordered plaintiff to make the change to variable pairing and that this constituted a compensable change. Claims 1.b and 6.a are for the costs of this alleged change. Defendant, on the other hand, maintains that plaintiff agreed to provide the variable pairing capability in return for the Government's willingness to accept only four L–119s in the DPSS/AUTODIN interface. The Board sustained the Government's position. It concluded that there had been an agreement reached between the parties pursuant to which plaintiff agreed to provide variable pairing as consideration for the Government's willingness to accept the reduction of L–119s from eight to four. "The Government," said the Board, "was contractually entitled to receive * * * [the initial] configuration or one of similar reliability. They [the parties] agreed upon a compromise whereby the appellant would furnish only four L–119's, but would add a variable pairing switching function to provide the necessary reliability." (73–2 BCA at 48,381.)

In its challenge to the correctness of the Board's decision, plaintiff raises, among other points, the contentions that (i) it did not have a contractual obligation to adhere to the initial configuration of eight L–119s, so long as it met contract performance requirements; (ii) that the four L–119s were functionally equivalent to the initial configuration of eight L–119s because the reduction in the number of L–119s was accompanied by an increase (a doubling) in

their transmission speed; and (iii) that it did not have a contractual obligation to demonstrate any minimum reliability as a condition to the Government's acceptance of the equipment. It is argued that these considerations, coupled here with the absence of any documentation evidencing the agreement found by the Board, demonstrate that plaintiff had no reason to effect the compromise agreement attributed to it by the Board and allegedly substantiate that the change to variable pairing was nothing more than an extra-contractual requirement unilaterally imposed by the Government.

Perhaps in another context these arguments would spell out a strong case. Here, however, they do not. The only question at this point is whether the Board's decision was based upon substantial evidence, and, on that score, there can be no doubt. Not only did the Board have before it the testimony of a Government witness who had attended the November meeting (and who claimed that an agreement had been reached at that meeting) but the record also contained plaintiff's own status report, prepared in April 1963, which recited the substance of the agreement in virtually the same terms alleged by the Government.[7] Moreover, to this proof, there would have to be added the equally telling fact that plaintiff produced not a single witness to refute the Government's testimony that an agreement had been reached at the November 7–8 meeting, nor any witness who could account for the change to variable pairing on some ground other than the agreement which had been claimed. Plaintiff's witnesses knew only that their superior in the Librascope organization had told them to make the change. But that superior himself did not testify.

Given this state of the record, the competing considerations that plaintiff now relies upon can detract little from the Board's decision. It does not matter, for example,

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[7] That report, dated April 15, 1963, states:

"Later it was shown that only four modules [L–119s] will be required (vice eight) to satisfy the system requirements. In consideration for this decrease in hardware Librascope has provided a redesign of remaining system elements pertaining to the L119's and also has provided the major effort in interface definition with AUTODIN."

whether the Board was right or wrong in viewing the parties' agreement as one grounded upon equipment reliability considerations, *i.e.*, that variable switching was resorted to in order to provide system reliability essentially equal to the initial eight L–119 configuration. For even if plaintiff is correct in now saying that it was not contractually required to demonstrate any minimum degree of reliability (a point we presently accept only for argument's sake)[8], this would not impair the basic correctness of the Board's decision, namely, that the parties did reach an agreement. That much, at least, the record unequivocally showed.

Nor is there anything to be gained by arguing, as plaintiff also does, that an agreement between the parties would have prompted the Government to formalize the arrangement in writing, as had, in fact, been done in like instances during performance of the contract. Clearly, the lack of such formalization cuts with equal force against plaintiff, for, if the variable switching mechanization did indeed portend the cost implications that plaintiff now assigns to it (the change having been introduced, according to plaintiff's argument, at an advanced point in the state of completion of the L–119s), then one can (indeed, must) question why plaintiff itself did not insist upon a written change order from the contracting officer. The absence of such a move on plaintiff's part suggests that what is claimed now as a change was really no change at all, or at least not one that had been unilaterally imposed.

The lack of specificity in plaintiff's proof is not bettered by the only documentary evidence that it offered in connection with this claim, namely, a copy of a trip report that was prepared by plaintiff's contract manager following the November meeting. That report contains the statement that "[i]t is required that the L–119's be switched in pairs and singly * * *." Plaintiff's argument emphasizes this "[i]t is required" language, saying that this

[8] Although it is unnecessary to discuss plaintiff's reliability argument, it should be noted that there is a significant difference between the absence of a contractual obligation to *demonstrate* reliability (the point plaintiff argues) and an obligation to design and deliver a system which could be expected to perform at certain reliability levels.

reflects the then contemporaneous unilateral action that was ordered by the Government.

The argument is weak. The language in question is, at best, ambiguous. It is impossible to say whether the author is indicating that the Government required the variable switching capability, that the specifications required it in order to meet the multi-thread capability, or that plaintiff's chosen design required the variable pairing. Certainly the document does not refute the testimony of the Government's witnesses that plaintiff agreed to make the change in return for defendant's willingness to accept four L–119s in the DPSS/AUTODIN interface. Assessed separately or *in toto*, plaintiff's arguments fail to show a lack of substantial evidence in favor of the Board's decision. The decision therefore stands.

Claim 6.d
Electronic Typewriter Interface Changes

A. *Direct Access from Electronic Typewriters into Central Processing Units*—Plaintiff's original design called for the path from the electronic typewriters of the Integrated Console Subsystem to the central processing units of the Data Processing Subsystem to be routed through two L-119s, one for each of the two central processing units in the COC configuration. In the equipment as delivered to the Government, the interfacing L-119s had been eliminated—the access from the electronic typewriters into the central processing units was direct. Plaintiff's claim is that this change was one which the Government unilaterally imposed.

It is not disputed that the Government was responsible for bringing this change into being. A finding to this effect was made by the Board. Instead, what remains in controversy at this point is the Board's conclusion that plaintiff had agreed to do this work—eliminate the interface buffers and provide direct access into the central processing units—at no additional cost to the Government in return for defendant's acceptance of a reduction in the number of L–119s from ten to four.

This last point mentioned, that is, the reduction in the number of L–119s, addresses the same subject previously discussed (Claims 1.b and 6.a); hence, the argument plaintiff now makes repeats some of the points that it earlier raised. Thus, again we meet the contention that there is no contractual evidence, that is, no written documentation, to support the agreement found by the Board. Again, too, the argument is raised that plaintiff's economic self-interest would never have counseled in favor of agreeing to the "trade-off" which the Board concluded the evidence had established.

The arguments are no more persuasive now than in their earlier setting. Aside from the fact that they cut with equal favor in the Government's direction—a point we noted earlier—there is also another and more substantial point which plaintiff overlooks, namely, the testimony of its own witness. While describing changes that had occurred in the DPSS/ICSS interface, plaintiff's technical director mentioned, among others, the high-speed channels that had been introduced on the electronic typewriter path. This point then led to the following colloquy between the Board member and the witness:

> Is this what has been characterized as that claim which resulted in the elimination of the L–119 and made the channel direct from the electric typewriters to the computer, the central processor?
> *The Witness:* Yes, I think at that time we did some trading with the SPO [System Program Office]. In exchange for the high-speed channel, we eliminated one L–119 [one L–119 for each of the two paths] and I think we also agreed not to argue whether we were supplying four or eight L–119's on the communication [this last refers to the subject matter of claims 1.b and 6.a].

The previously quoted testimony, the substance of which was repeated again in the course of the Government's later cross-examination of the same witness, is not dealt with in plaintiff's present arguments. There the point is simply ignored and other arguments are pursued instead. However, these other arguments, though examined, need not be identified here. It is enough to say of them that they neither detract from nor minimize the testimony elicited from plaintiff's witness. That testimony, which was certain-

ly not inherently improbable nor contradicted by any other testimony or circumstances disclosed in the record, fully supports the conclusion that was reached by the Board.

B. *Direct Access from Central Processing Unit into Electronic Typewriter*—By the terms of the contract, Librascope was required to provide the Government with a specification setting out data relevant to the eventual interface between its own subsystem, the DPSS, and the ICSS, the subsystem whose design and manufacture was to become the responsibility of another contractor. Because of Librascope's delay in developing this interface specification, the System Program Office decided to appoint an industry-Government advisory group—referred to as SIDG (Subsystems Integration Design Group)—to consider the interface problems likely to be encountered, to develop solutions to these problems and, in the overall, to coordinate development of the DPSS/ICSS interface specification. The SIDG was a composite group; its industry members came from Librascope, IBM, ITT, and MITRE, and its Government members came from RADC and ESD.

As a consequence of the meetings that were held by this advisory group and the interchange of ideas that resulted therefrom, certain changes were introduced into Librascope's originally envisioned DPSS/ICSS output interface. Among these was a change in the message path from the central processing unit to the electronic typewriter. Initially what had been proposed was a message path routed through the mass memory. What finally was delivered, however, was a system in which communication from the central processing unit to the electronic typewriters was accomplished by direct access.

Librascope sought compensation for this change on the theory that the Government, acting through the SIDG, had unilaterally ordered this changed configuration in the mass memory output interface. The Board rejected the claim saying, "[t]he change * * * was not one directed by the Government. The record does not even disclose who originated the suggestion; whether it was the appellant, the Government, or one of the other contractors. All that is disclosed is that someone at the first SIDG meeting made this as a suggestion * * * [and that] [t]here was a general

consensus that this was an excellent solution, and appellant implemented it." (73–2 BCA at 48,387.)

The contractor attacks both aspects of the Board's conclusion. It contends, first of all, that the individual responsible for the change (meaning, in this situation, the individual whose recommendation it was that first prompted the SIDG's discussion of the matter) was the Government's representative from RADC—an individual who served not only as chairman of the advisory group but also as technical assistant to the director of the entire 473–L program. Secondly, plaintiff contends that, by virtue of the authority vested in the SIDG, the actions taken by that group became, in effect, actions taken by the contracting officer.

We agree with the Board that the evidence does not disclose whose recommendation it was that ultimately brought about the change in question. However, given plaintiff's main argument, that it was the advisory group as a whole that was vested with change-directing authority, it becomes unimportant to pass upon the actions of its individual members.

There is no question that the advisory panel recognized that, in its definition of system interface requirements, it might hit upon solutions to technical problems that would impact upon the boundaries of the then-approved design. Nor is there any question that plaintiff's technical director considered SIDG's technical solutions as the equivalent of directives—functions that had to be implemented because as he put it, "[i]f we didn't build the interface that way [meaning, per SIDG solutions], we would never deliver the equipment." As plaintiff sees the situation, these two factors—the recommendations of SIDG on the one hand and their implementation by Librascope on the other—establish plaintiff's right to recover. They do not.

To begin with, the advisory panel did not operate in the freewheeling fashion that plaintiff's brief seems to suggest. There was not a disregard by SIDG of the contractual implications of the action that it was generating. On the contrary, in the course of his testimony, the Government's SIDG representative—the chairman of the group—emphasized that, at their first meeting, it was made known to all

participants that SIDG was an advisory body only and as such, no SIDG member would have authority to bind his respective organization, nor would any member have authority to direct the implementation of any technical decisions resulting from SIDG's deliberations.

Furthermore, even though SIDG did not have a clear perception as to the contractual actions that might be necessary in order to formalize its technical decisions, the important point is that there was an awareness, as the Government witness said "that there would have to be some sort of a corporate government agreement formalized, which would pick up all of the information generated by the SIDG."

Plaintiff's own witness (its representative at the SIDG meeting) did not understand the situation any differently. While he disputed the point that there had been any initial discussion respecting limitations of authority, he nevertheless understood the SIDG meetings to be technical discussions without authority for commitment. He also acknowledged that, with respect to design changes recommended by SIDG that were subsequently incorporated by Librascope in its equipment, "it was a common understanding that one way or another there would be shakeouts with regard to cost and scope [meaning, a resolution by contract means of any additional costs associated with design changes]."

As anticipated by the above-quoted testimony, contractual follow-up to SIDG's actions did take place. On October 16, 1962, the System Program Director forwarded to Librascope a draft of the interface specification that had been generated by the SIDG meetings. The accompanying transmittal document requested the 473–L contractor and subcontractors to review the draft specification "to determine whether the design constraints implied therein are within the scope of existing contracts and signify acceptance and exceptions to the 473L SPO by TWX * * * followed by a signed letter of acceptance." Librascope responded on October 24, 1962. Its telegram of this date stated that it was "TO SIGNIFY CONCURRENCE WITH SUBJ. [interface] DESCRIPTION WITH FOLLOWING EXCEPTIONS." Of the four exceptions that were noted,

none dealt with the present claim—the interface between the central processing unit and the electronic typewriter. Neither did the telegram make any reference to any demand for additional compensation based upon "out-of-scope" work.

Given the facts recited above, it is apparent that SIDG-sponsored technical changes were not changes unilaterally imposed upon Librascope. The contractor had a voice in the matter from the very beginning of the interface discussions. Furthermore, even if Librascope felt itself obliged to go along with SIDG's recommendation in order to sidestep any schedule delays that might otherwise have resulted, it was certainly not denied the opportunity to point out, and claim additional compensation for, any changes that transgressed the parameters of its own design. The fact that Librascope did not raise its present claim as an exception to the interface specification is an action that speaks for itself. Thus, while the Board's conclusion that the Government did not order the change is perhaps a more abrupt answer than the underlying circumstances require, it still fits the facts enough to be correct. The Government endorsed the technical feasibility of SIDG's recommendations, submitted them for evaluation to plaintiff (for technical as well as contractual assessment) and plaintiff, in turn, accepted them. In the last analysis then, it was plaintiff's concurrence with SIDG's recommendations, rather than a Government order, that led to the implementation of the change in question.

In an effort to undo its earlier-expressed acceptance of the interface specification, plaintiff now points out that it never submitted, as a follow-up to its acceptance telegram of October 24, 1962, the signed letter of acceptance that had been requested by the System Program Director. From this omission we are presumably being asked to conclude that plaintiff never agreed to implement the interface specification on a no additional cost basis.

The point is irrelevant. Plaintiff points to nothing in the record to warrant the conclusion that either party intended to postpone a binding contractual commitment until evidence of their understanding had been formalized by way of a signed letter of acceptance. The Government's

letter of October 16, 1962, asked Librascope to signify its acceptance and exceptions by telegram, this then to be followed by a signed letter of acceptance. In its telegrammed response, Librascope noted its concurrence. These manifestations of assent were sufficient in themselves to conclude an agreement and contract law would not inhibit such effect merely because the parties may also have manifested an intention to prepare and adopt a later written memorial of their agreement. RESTATEMENT (SECOND) OF CONTRACTS § 26 (Tent. Drafts Nos. 1—7, 1973).

Claim 6.c
Addition of Interrupts to Input/Output Interface and Mass Memory Interface

Plaintiff had proposed, and its contract required, that the DPSS equipment have an interrupt capability in certain situations. An interrupt is a feature that allows the execution of a computer program to be suspended in order to permit the computer to become immediately responsive to the reception of new material. The interrupt is necessary to accommodate an outside signal or permit a response to the detection of an error in data transfer. In Claim 6.c plaintiff seeks additional compensation for certain interrupts that were included in the system. Since separate factual circumstances are involved in each situation, it is necessary to deal with the problems on an individual basis.

A. *Integrated Console Subsystem Message Available Interrupt*—In the system configuration as initially envisioned, plaintiff had planned to mechanize an interrupt capability in that L–119 buffer processor which linked the central processing unit of the Data Processing Subsystem with both the electronic typewriters and the digital data links of the AUTODIN communication system. This initially planned interrupt was to be referred to as "input-any," meaning, in effect, that the central processing unit could be signalled to receive a message, transmitted through the "linking" (our word) L–119 buffer processor, originating from any of the electronic typewriters of the Integrated Console Subsystem or any of the digital data links of the communication system.

As discussed in Claim 6.d, this linking L–119 was eliminated and in its place was substituted a high-speed channel that provided direct access to the central processing unit. Because of this change in configuration, it became necessary to revise and enlarge the interrupt capabilities in order to accommodate both the Integrated Console Subsystem's electronic typewriters and the digital data links of the AUTODIN communication system. The configuration that emerged was described by plaintiff's witness as comprising the following: an "L–119 Message Available Interrupt," an "electronic typewriter (ET) input" or "ICSS Display Console Message Available Interrupt," an "L–119 input" or "L–119/ET Interface Not Busy Interrupt," and, finally, a "major" interrupt (as opposed to the first described interrupts which are termed "detail" interrupts), known as the "I/O (input/output) Interface Interrupt." Of these four interrupts, the three last listed are claimed to represent extra-contractual effort for which additional compensation remains owing.

In its treatment of this particular claim, plaintiff has related the origination of the L–119/ET Interface Not Busy Interrupt (one of the four interrupts which the witness had described) to circumstances other than the design modification that brought about the direct access, high-speed channel earlier mentioned. The reason for this departure from the witness' testimony is not clear. At any rate, the present claim is limited to two interrupts—the ICSS Display Console Message Available Interrupt and the master I/O Interface Interrupt. And, as to these, what plaintiff claimed was that the same set of circumstances which supported its right to recover for the change to direct access between the electronic typewriters and the central processing units likewise supported its right to recover for the additional interrupts which that change had occasioned.

The Board denied the claim saying that, "[t]he interrupt changes made necessary by the change to direct communication between the CPU [Central Processing Unit] and the ET [electronic typewriters] were merely details of that transaction." (73–2 BCA at 48,389.) And, since plaintiff was found to have agreed to provide direct access at no

additional cost, it was therefore not entitled to any further compensation for implementing the interrupt changes attendant to that basic change.

We agree with the Board's conclusion. In its presentation of this particular set of interrupt claims, plaintiff claimed the same causal connection which the Board eventually relied upon, that is, given the basic change to direct access between the two subsystems—the integrated console and the data processor—the interrupt mechanization changes now in question had necessarily to follow. In other words, the changes were, as the Board called them, "details" of the basic change. Given this connection, and also the Board's conclusion that the provision for direct access was, in and of itself, a matter of agreement between the parties, it would seem to follow that that agreement intended also to include the necessary changes to the interrupt configuration. At least, as presented, the claims allow that conclusion for nothing in the proof says otherwise.

B. *L–119/ET Interface Not Busy Interrupt and L–119 Output Message Available Interrupt*—The second series of interrupt changes in the central processing unit interface for which plaintiff asks recovery are those referred to as the L–119/ET Interface Not Busy Interrupt (identified in section "A." above) and the L–119 Output Message Available Interrupt. Neither of these interrupts was specifically called out in plaintiff's proposal; both are claimed now to represent changes that plaintiff was obliged to include in its final design. The principal argument made below was that this alleged additional work had been required by IBM, a parallel contractor charged with providing technical assistance to the Government who, according to Librascope's argument, came to acquire the status of a representative of the contracting officer.

The Board found no merit in this claim. With respect to the L–119/ET Interface Not Busy Interrupt, the Board noted that there was general testimony, on plaintiff's part, to the effect that this interrupt had been included at IBM's request and Government testimony saying the interrupt was required by the terms of the contract. However, the Board also made the observation (one with which we entirely agree) that the evidence was "too scant to permit

detailed findings." (73–2 BCA at 48,389.) Despite the limitations in the proof, the Board concluded that information signaling the completion of an input/output operation had to be conveyed to the central processing unit in some manner, meaning, that some form of interrupt capability was necessary. It further concluded that, since this particular interrupt capability occurred in the interface between the communication system (AUTODIN) and the data processing system (as opposed to the interface between the integrated console and the data processing subsystem), the interrupt feature required mechanization by hardware means rather than by software. Expressed in contract terms, this hardware requirement meant that the interrupt feature was plaintiff's responsibility rather than the responsibility of the contractor charged with development of the software program. (The difference between hardware and software is explained below.) As to the L–119 Output Message Available Interrupt, the Board's conclusions were the same: the interrupt capability was required by MIL–D–27113 and, since it too was located in the AUTODIN interface, it likewise had to be provided by hardware.

With respect to plaintiff's argument claiming IBM to have been the moving force responsible for requiring the addition of the interrupts, the Board simply held that the evidence failed to establish that the L–119/ET Interface Not Busy Interrupt was the product of a directed change. As to the other interrupt, which plaintiff had likewise attributed to IBM's demands, the Board made no conclusion save the point noted above, *i.e.*, that the work was required by the contract's terms.

In the argument which plaintiff now presents, the question is no longer whether the interrupt capabilities in issue were required by the terms of the controlling specification, namely, MIL–D–27113. This much of the Board's decision the contractor does not quarrel with. Rather, as here refined, the question is whether these capabilities had to be provided by hardware means or could, instead, be satisfied by software. As had been explained in the testimony of plaintiff's technical director, a hardware means of interrupt mechanization is required

whenever there is a need to command the computer's immediate attention, that is, the need to go from a program in execution to an external program unique to the specific cause of the interrupt. Software interrupt mechanization, on the other hand, is a programmed or preplanned interrupt system whereby the computer, at specified time intervals, communicates with input indicators to determine whether there are any messages awaiting processing. It was further explained—again by plaintiff's witness—that all so-called synchronous interfaces required hardware interrupt. And, among these synchronous interfaces, the witness included the "L–119 to Autodin" as well as "output to Autodin." It was upon this last point—the identification of the AUTODIN interface as a hardware-requiring interface—that the Board relied. It is this same point which the contractor now challenges.

Plaintiff contends that the requirement for hardware mechanized interrupts in synchronous interfaces applied only to data transmission channels and not to interrupts of the type in question. The latter, claims plaintiff, were "status-seeking" interrupts, meaning, that their purpose was only to question the availability of the L–119 for communication rather than be involved in data transmission. Thus, according to the argument, there was no necessity for hardware; the same interrupt capability might as readily have been accomplished through programming (*i.e.*, software) in which case the contractual responsibility rested elsewhere than with plaintiff.

It is impossible to decide whether this argument is right or wrong. The testimony upon which plaintiff relies simply does not make the point with any clarity, if, in fact, it makes the point at all. That testimony was often incomplete and often confusing and, on the record as it stands, we simply cannot say that the Board's conclusion lacked the support of substantial evidence.

Furthermore, even if the evidence could have permitted the above-discussed point to be resolved in plaintiff's favor, the claim would still fail. There was no evidence of any substance to support the principal argument that had been made below, namely, that the interrupt changes had been ordered by IBM or that that company, in its capacity as

technical assistant to the Government, had come to dominate plaintiff's contract efforts.

First, with respect to the L–119/ET Not Busy Interrupt, plaintiff's only evidence of IBM involvement was a chart, admittedly prepared by an IBM employee, showing this particular interrupt. However, there was no evidence saying that this configuration had been proposed—much less ordered—by IBM. Thus, for all we know, the chart might just as easily have reflected IBM's understanding of plaintiff's proposed design. Indeed, there is more than a casual basis for such speculation. For one thing, the chart was part of a series of notes identified (in the written material itself) as having been "obtained" during a meeting at Librascope on October 29, 1962 through November 6, 1962. Then too there is the fact, mentioned earlier, that this particular interrupt had been described by plaintiff's witness as an interrupt connected with the change to direct access between the electronic typewriters and the central processing units—a change with which IBM had had no connection whatsoever. In short, what we have is a situation in which the evidence fails to establish the point for which it was offered while, at the same time, admits to inferences that undercut plaintiff's position.

As to the second of the interrupts claimed here, the L–119 Output Message Available Interrupt, the proof is no better. The evidence consisted solely of a memorandum from IBM to the 473–L System Program Office requesting the inclusion of an interrupt capability equal to that provided by the L–119 Output Message Available Interrupt. The witness through whom this document was introduced at the hearing did not indicate that there was any causal relationship, exhibited by this correspondence, between IBM and the System Program Office on the one hand, and the contractor's inclusion of the requested interrupt capability on the other. Nor, it might be added, did any other witness provide such testimony. In fact, we have no evidence that Librascope was ever furnished a copy of this letter. All that was said was that the interrupt was not part of plaintiff's original design and that, in the opinion of the witness, the interrupt was not required by the terms of the contract. Beyond doubt, this was not

enough to attribute the change to IBM and, thereafter, indirectly to the Government.

C. *Display Depleted Interrupt (End of Transfer Interrupt for Mass Memory)*—There is no dispute that the contract specification, MIL–D–27113, required the equipment supplied by plaintiff to have the capability of interrupting the program upon completion of a display output by the mass memory. The contract designated this function as one which would be fulfilled by an interrupt and plaintiff's proposal indicated that such an interrupt would be provided. However, that proposal did not specify whether this Display Depleted Interrupt would be accomplished with hardware or with software. Plaintiff claims that it had originally planned to provide the function with software, that it was not precluded from doing so by the contract specification, and that the Government unilaterally ordered it to provide a hardware interrupt for this function. Plaintiff asserts that this is a compensable change.

Struggling with a record that can only be considered obscure and confusing, the Board found that the specifications were not clear as to whether the interrupt function required the use of hardware or could have been accomplished with software. It also found that the Government interpretation was better (from a technical standpoint) than plaintiff's and that, in any event, Librascope had waived its right to claim a compensable change in that it had agreed with the interpretation it now attributes solely to the Government. The Board's view of the facts of this claim is correct, and the result it reached—a denial of the claim—was proper.

There is no dispute that the requirement for a hardware-mechanized Display Depleted Interrupt originated with the Government. Likewise, it is not disputed that, in asserting this position, the Government was pressing for nothing more than what it believed was required by the governing contract specification, MIL–D–27113.

But, on plaintiff's side of this issue, there existed less unanimity of thought. As the Board noted, one of Librascope's engineers (a witness at the trial) was of the view that the interrupt function was not at all required by

the governing specifications, that is, neither hardware nor software had to be provided. Another of plaintiff's witnesses, Librascope's technical director, conceded the existence of the requirement but, at the same time, was of the view that, contractually speaking, the requirement could be satisfied by software rather than by hardware means. He allowed, however, that while the change from software (the approach Librascope had planned) to hardware (what the Government required) represented a major change, the difference in contract interpretation underlying the two approaches "was arguable."

At any rate, this difference in contract interpretation notwithstanding, Librascope did proceed to do the work according to the Government's interpretation, that is, provide the interrupt capability by hardware means. And, so far as this record reveals, the work was done without notice to the contracting officer that Librascope considered the effort involved to be extra-contractual. There was no protest from any authorized corporate spokesman.

The contractor's failure to protest, while perhaps not an outright bar to the claim, is nevertheless an evidentiary consideration which, in these circumstances, takes on controlling significance. For, on this record, with the evidence as sparse as it is, Librascope's decision to do this admittedly "arguable" work without protest could mean that it came eventually to agree with the Government's position, or, alternatively, that it had chosen, for reasons of its own, not to press the point. The record simply does not tell us why the issue was never carried to the level of the contracting officer. All we know is that plaintiff's technical director, while disagreeing with the Government's position, conceded the point was arguable and conveyed these thoughts to Librascope's contract spokesman. There the evidence ends. The work was done and nothing more was said until after all work had been completed. Thus, the facts admit of two possible conclusions: that Librascope ultimately accepted the Government's interpretation as correct, or, as the Board saw the situation, that Librascope deliberately waived its right to assert a claim under the Changes article of the contract. In either case, the contractor's conduct, though purely negative, manifested a

purpose or intent upon which the Government was entitled to rely. The right to press a claim was thereby extinguished.

Claim 9
Reliability Report

Plaintiff's contract required that it prepare a report setting forth reliability predictions for the equipment that it was supplying to the Government. A preliminary version of this report was submitted on June 27, 1962. On July 31, 1962, the Government rejected the report. Its criticisms included the facts that the calculations had not been based upon the latest version of the statistical guidelines referenced in the contract and also that the calculations had not included the peripheral equipment—the so-called "off-the-shelf" items which had been obtained from commercial suppliers. The Board upheld the Government's position on each of these points. The contractor raises them again here; we agree with the Board.

A. The first branch of this two part claim concerns Librascope's allegation that it was required, by the Government, to prepare its reliability predictions by reference to a document other than the one which had been specified for that purpose in the contract. This alleged change in reference documents necessitated extra effort for which recovery is now being sought.

The contract provided that the contractor should calculate reliability predictions for the equipment in accordance with the Armed Services Technical Information Agency (ASTIA) document, AD–148868 Reliability Notebook (also referred to as the RADC Reliability Notebook). But, as to this documentary reference (as well as others which the contract listed) it was also stated that the applicable document would be "the issue in effect on date of invitation for bids * * *."

In the preparation of its preliminary reliability report, Librascope used the document called out in the contract, namely, RADC Reliability Notebook AD–148868. As indicated, the Government disagreed with the contractor's use of this document because it did not represent what the

Government considered to be the latest version of that document, namely, the revision dated December 31, 1961. However, this revision bore a different identifying number—PB–161894 rather than AD–148868—and it had been issued by a different agency of the Government, being a Commerce Department document rather than an ASTIA document.

Because of this change in identification number and issuing source, the contractor now makes the argument that the two documents were not the same—one was not an updated version of the other. Thus, according to this view of the matter, there was only one RADC Reliability Notebook which the contractor was contractually obliged to follow, namely AD–148868, the one which the contractor did use. To round out this argument, the contractor also says that there was no evidence in the record to permit the conclusion arrived at by the Board—that PB–161894 was the controlling document.

The argument is without substance. In its letter advising the contractor of the disapproval of the preliminary reliability report, the Government spelled out that "[f]uture calculations should be based on data from the current RADC Reliability Notebook, dated 31 Dec 61." This criticism was repeated when the Government received, and again rejected, the contractor's revision of the preliminary reliability report. Once more attention was called to the fact that "[t]he latest revision of the RADC Notebook is 31 December 1961, and should be used in place of the 30 October 1959 data." Not only did plaintiff not question the correctness of the Government's instructions on this matter but, during the course of the trial, plaintiff's technical director specifically stated that he agreed with the bases for rejection which the Government had pointed out. Furthermore, during cross-examination of this witness, the question was specifically asked whether the RADC Reliability Notebook that was in effect at the time of the invitation for bids was Revision 2, dated December 1961. The witness answered the question by saying, "I think so."

If there had been any doubt as to the correctness of the point which plaintiff's own witness had conceded, the matter could readily have been resolved simply by intro-

ducing into evidence the two documents whose relationship the contractor now questions. However, that evidence was not made a part of the record. Thus, all we now have is simply argument, unsupported by proof, that the documents were distinct rather than different versions of the same basic source material. That is not enough to prevail. The evidence as it stands supports the Board's conclusion that the contractor was contractually bound to use the document which the Government had insisted upon.

B. The second part of this claim concerns the contractor's allegation that it was not required, by the terms of the contract, to include reliability figures for off-the-shelf equipment such as electronic typewriters, line-printers, card readers, punch controls, and magnetic tape transports. The Government had required this work, and, as noted, the Board sustained the Government. The Board based its conclusion on the fact that the specifications made no distinction between equipment manufactured by plaintiff and equipment it might purchase from others; reliability was addressed only in terms of the equipment as a whole.

The contractor's argument against the correctness of the Board's decision raises two points. First, it is pointed out that at the bidders' conference (pre-award), the Government had actively promoted the use of off-the-shelf items and that the contract, as executed, carried this purpose forward. (A paragraph in the contract recited that "[i]t is desired that the Data Processing equipment be off-the-shelf equipment.") Plaintiff goes on to point out that bidders had been told that off-the-shelf equipment could be used even if such use entailed a deviation from applicable military specifications. In view of these circumstances—the announced preference for off-the-shelf items which could be accommodated despite the equipment's failure to meet all applicable military requirements—plaintiff allegedly concluded that reliability predictions for such components would not be required. The reason for this conclusion on plaintiff's part is not explained but, at any rate, it was because of this conclusion that plaintiff claims that the scope of the reliability predictions set out in its technical proposal was limited strictly to equipment it manufactured

itself. It did not propose to furnish reliability predictions on any off-the-shelf equipment it might also be supplying. Thus, plaintiff relies upon the scope of its own proposal, and indirectly upon the acceptability to the Government of off-the-shelf equipment, to support the argument that reliability predictions were contractually required only for its own equipment.

There are two answers to plaintiff's argument. First, with respect to the off-the-shelf items, the notes of the bidders' conference make clear that the Government's preference for off-the-shelf equipment was not meant to imply a sacrifice of equipment reliability considerations. In fact, just the opposite was true. The point was several times made that off-the-shelf equipment could be used provided it was built according to best commercial practices *and* exhibited satisfactory reliability characteristics. By way of example, the Government explained:

> * * * A non-mil [*i.e.*, non-military, meaning off-the-shelf equipment] console built to best commercial practices will be acceptable if there is a good indication that it will pass in Category I testing. This is the functional adequacy test of the equipment. If there is such a console built *and you have statistical data of at least 6 months duration showing the actual reliability expected of the machine* we will accept this in proposals as an indication of passing Cat. I tests. [Emphasis supplied.]

Given the above statement (one of several answers of like import made by the Government at the bidders' conference), it is impossible to understand how Librascope could have come to the conclusion that use of off-the-shelf equipment, whether modified or not, should relieve it of the contractual obligation to furnish reliability predictions for such equipment. It might be added also that, quite aside from what was said at the bidders' conference, the same conclusion could have been reached simply from the contract language. That part of the contract which stated the Government's preference for off-the-shelf equipment (the clause previously quoted) went on to say that, if the proposed use of off-the-shelf items should necessitate trade-offs in specification requirements, then "an explanation of their effect [*i.e.*, the trade-offs] on the overall system is

required." Most certainly, this language should have told the contractor that the Government was as much interested in the performance characteristics of off-the-shelf equipment as it was in the contractor's own equipment. Accordingly, to restrict reliability considerations only to the latter would make no sense at all.

As to the other part of the argument, namely, the claim that Librascope's technical proposal restricted reliability predictions only to its own equipment, this too is without substance. In its technical proposal, Librascope had stated that "[t]he Contractor agrees to the inspections and tests required by paragraph 4 of MIL–D–27113" and its "reliability program will comply with MIL–R–27542." These specifications, MIL–D–27113 and MIL–R–27542, were among the specifications referenced in the proposed contract which accompanied the Government's request for proposals and, concerning these specifications, the Government had advised all bidders (at the briefing conference) that adherence would be mandatory—the specifications represented contract requirements. These same specifications set out, among other things, the requirement for reliability predictions. And this requirement was not limited, as the contractor would now have it, simply to contractor-manufactured equipment. The requirement was addressed to the system as a whole.

For example, paragraph 4 of MIL–D–27113 stated that the reliability of the equipment was to be tested in accordance with MIL–R–26474 and the latter specification, in turn, identified the requirement for reliability estimates in terms of "the total final equipment configuration." MIL–R–27542 said the same thing, but said it even more clearly. It recited that "[w]here other equipment, such as Government furnished or associate contractor supplied equipment are integrated in the system to provide a complete operational system, the contractor shall use known or estimated reliability values for these equipments."

In view of the representations made in its technical proposal that the reliability program would comply with MIL–D–27113 and MIL–R–27542, Librascope pursues an irrelevancy to argue, that since its proposal had only identified self-made equipment as the subject of required

reliability predictions, its contractual obligation should be narrowed accordingly. The proposal was general, not specific or detailed, and if Librascope really meant to restrict its obligation, it should have said so in no uncertain terms. Whether, in that event, the proposal would have remained sufficiently responsive to the Government's requirements to be considered acceptable is, of course, another matter. The point is, however, that the proposal said nothing in this regard. Thus, given the "outline" nature of the proposed along with the specific statements promising compliance with the applicable reliability specifications, the Government was entitled to assume that the proposal intended full compliance with all that those specifications entailed. In short, when the Government insisted that reliability predictions include the off-the-shelf equipment, it was insisting upon nothing more than what the contract and an honest reading of the proposal both required.

Claim 10.d
Preparation of Category I Test Plan

As part of its work under the contract, plaintiff prepared and implemented a program of tests designed to ensure that the equipment met Air Force requirements. This testing program, referred to as the Category I Test Plan, is the subject of plaintiff's Claim 10.d. Plaintiff's contentions are that, under the contract, its responsibility was limited to identifying and carrying out the tests that should be conducted and that the responsibility of actually developing and writing the test program represented extra-contractual effort which it was obliged to assume because of the Government's orders. It contends too that this alleged extra work on its part was actually the responsibility of another contractor, IBM, to whom this work had been assigned by way of a separate contract.

Essentially, the same arguments were made below and all were there rejected. The Board decided as follows: (i) that the mentioned IBM contract pertained only to Category II testing and therefore was of no useful purpose in determining the scope of plaintiff's contractual obliga-

tions with respect to Category I testing; (ii) that, contrary to plaintiff's contention, paragraph 5.23 of Exhibit "A" (the basic statement of work) did not impose upon the Government responsibility for preparing the Category I Test Plan; and (iii) that, during the course of performance, the conduct of the parties was such as to convincingly demonstrate that each regarded the preparation of the test plan to be plaintiff's responsibility. We agree with the Board's several conclusions.

Addressing first the contention that the work in question was actually IBM's responsibility rather than plaintiff's, there is no proof at all of this point. Plaintiff's brief does quote a paragraph of the IBM contract but we have no way of knowing whether the bracketed explanations—what plaintiff refers to as "internal notations supplied"—that plaintiff has added to the text of the quoted paragraph actually represents a correct reading of that paragraph. It would be for us nothing more than guesswork to accept the position that, in speaking of testing, the reference in the IBM contract to "OTC/IOC/COC phase of the system" actually identifies a requirement for Category I subsystem testing. Nor is our understanding bettered by reading the IBM contract in its entirety. So far as we can discern, that contract speaks only of Category II testing; if it does say more than this, then plaintiff has failed to prove it.

As to the language in plaintiff's own contract, the Board recognized that the relevant paragraph, paragraph 5.23, did not admit of any conclusion on the point in issue save the fact that that paragraph did not place upon the Government the responsibility for the development of the test program. (That paragraph simply said that "[t]he contractor shall conduct the necessary Category I testing * * * [and] [t]he 473L System Program Office retains responsibility for proper test design, conduct, evaluation and direction of these tests.") The Board was of the view, however, that any deficiency or vagueness in the language of the contract was remedied by a course of conduct in which both parties acted from the common premise that the development of the test program was as much the contractor's responsibility as was the identification and conduct of the tests themselves. In other words, the Board

adhered to the familiar rule that contract provisions later brought into dispute should be accorded that meaning which is reflected in the parties' conduct during performance and while their relationship was harmonious.

It would serve little useful purpose now to restate all the facts upon which the Board rested its conclusion. It will suffice to point out that plaintiff initiated the development of the test plan without Government prompting and, over a course of many months, undertook to develop that plan in depth. There was much correspondence and discussion between the parties on this matter, and during all this time no protest was ever raised by plaintiff claiming, as it does now, that it was being asked to do more than what its contract obligated it to do.

The contention raised in plaintiff's brief that it had initially agreed, "essentially as a courtesy to defendant," to specify the tests that would be required for acceptance of the equipment is pure invention. Nothing in the record, be it testimony or documentary evidence, supports this assertion of limited responsibility gratuitously assumed. Equally devoid of substance is the argument that no negative inference should be drawn from the fact that plaintiff "did not continue to object" to the expansion of the test plan requirements. This too is fabrication; the real point is that plaintiff never *once* objected. Also in this connection, it should be noted that there is nothing in the record to support the argument that, at a meeting between the parties on December 11–12, 1962, the Government ordered plaintiff to prepare a Category I Test Plan. The notes of that meeting are devoid of any reference to a Government order to plaintiff; so too is the transmittal letter that accompanied these notes. This last says simply that "[t]hese notes may be used as a guide in writing the referenced paragraphs of the outline which was discussed." The extensive examination of the parties' actions and their correspondence that appears in the Board's opinion fully supports the conclusion that the preparation of the Category I Test Plan was understood by Librascope to be its own responsibility.

Opinion of Trial Judge

Claim 3.c

Testing to Improve Reliability of Magnetic Tapes

This claim concerns the contractor's contention that it was required to expend considerable time and money in an attempt to improve the reliability of the magnetic tapes—off-the-shelf items that were included as a part of the system's so-called peripheral equipment. The Board denied the claim for failure of proof. Specifically, the Board said "[t]he documents show that the appellant made a substantial effort to improve the reliability of the magnetic tapes. They fail to show that this was at the insistence of the Government." (73–2 BCA at 48,398.) We agree with the Board's result but not with the reasoning supporting it.

Our difficulty with the Board's decision begins first with the fact that, in connection with a different but related claim (Claim 9), the Board apparently acknowledged the very point which it judged to be missing from the contractor's proof on the present claim, namely, that reliability testing was imposed upon the contractor and that this testing did include the peripheral equipment. Thus, in connection with that earlier claim, the Board, after finding that the contract did not include any minimum reliability figures (also referred to as mean-time-between-failure rates or MTBF rates), then went on to say:

> * * * The Government ordered appellant to test the equipment to imposed MTBF criteria as a part of the Category I acceptance tests * * *. Appellant and the Government agreed finally upon the criteria to be met and the test methods. *It* [Librascope] *did not agree that the peripheral equipments should be included in the tests.* [73–2 BCA at 48,397; transcript citations omitted; emphasis supplied.]

Though not stated directly, the point plainly implicit in the above-quoted paragraph is that the Government's order to test the equipment to imposed MTBF criteria included the peripheral equipment.

This same conclusion is also evident in what the Board had to say in regard to one of several related contentions included in plaintiff's Claim 10.d (the claim for the preparation of the Category I Test Plan). As stated by the

Board, it was the contractor's position that the "Reliability Testing Annex" to the Category I Test Plan (one of several appendices to the basic test plan) represented, in and of itself, an extra-contractual undertaking on the theory that the reliability requirements set forth in the test plan reflected the application of MTBF figures and reliability testing which the Government had unilaterally imposed. Simply put, the contractor's argument was that the reliability test plan should not have been required for there was no contractual requirement for reliability testing in the first place. Of this claim, the Board said:

> * * * This allegation with regard to increased reliability requirements was the subject of Claim 9. *It* [Librascope] *should be allowed to recover under this claim for including the increased requirements in the Test Plan. We stated that this might be extra work as to peripheral equipments,* but the record affords no method of allocating that part of appellant's total cost of the test plan to the peripheral equipments. [73–2 BCA at 48,419; emphasis supplied.]

What is significant about each of the two above-quoted paragraphs, and the reason we cite them here, is that what the Board saw as enhanced reliability requirements imposed by the Government, *i.e.*, its alleged imposition of minimum MTBF figures, had a direct impact upon peripheral equipment reliability—that equipment had to be tested to prescribed values and a plan for the testing of that equipment had to be written. Thus, if we accept the Board's premise that the contract did not originally include MTBF figures and that the Government unilaterally imposed such figures upon plaintiff (and also their demonstration through testing) then the Board would clearly have been wrong in saying, in regard to the present claim (Claim 3.c), that the contractor's proof failed to show that the reliability testing of the magnetic tapes was done at the Government's insistence. On the facts of this case, the imposition of MTBF figures necessarily implied that all equipment in the system would be subject to reliability testing; indeed, this is the very point which the contractor now argues.

And it is this, then, which brings us to the second and more essential point in the Board's decision. We disagree with what appears to have been the Board's premise, namely, that the Government overstepped its contractual rights by requiring the contractor to meet and to demonstrate certain MTBF levels.

By the terms of the contract, plaintiff was, in fact, required to meet a specified mean-time-between-failures rate. True, the contract did not provide this information in terms of specific numbers but it did reference a mathematical formula from which the contractor could calculate the MTBF rate applicable to its equipment, this based on the number and types of components in the design.

The relevant documents were MIL–D–27113 (this was the basic military specification for the Data Processing Subsystem for the 473–L System) and MIL–R–26474. The former stated, in paragraph 3.2.1.5., that minimum reliability requirements "shall be in accordance with MIL–R–26474 except the part failure rate from the minimum mean-time-between-failures (MTBF) shall be obtained from the ASTIA AD–148868 (section 8)." The latter, MIL–R–26474, provided a formula for the calculation of minimum mean-time-between-failures. This latter specification also stated that:

> When the detailed equipment specification [in this case MIL–D–27113] requires compliance with this specification, the final design and construction of the equipment shall provide as a minimum, the degree of reliability specified herein. The following requirements [which included MTBF values derived by formula] establish minimum levels which the contractor shall be required to provide and demonstrate.

The above-noted documents, together with the testimony of the Government's witnesses on this issue, show that the contract not only mandated that the contractor meet reliability requirements but also that it indirectly specified the governing MTBF values. To the extent the Board held otherwise, its decision was erroneous as a matter of law. Denial of recovery for reliability testing of the magnetic tapes is affirmed on the ground spelled out above—such testing represented a contract requirement.

There is one last point that warrants comment. In its brief before the Board the contractor had argued that only MIL–D–27113 represented a contract requirement whereas MIL–R–26474 was claimed to represent nothing more than "a design objective or goal." The Board did not address this issue (at least not in the claims presented in this appeal) nor did plaintiff raise the point here. However, in view of our treatment of this claim and our reliance upon MIL–R–26474, it is appropriate to give a brief answer to this point.

The argument is based, in part, upon the response to a question raised during the bidders' conference. On that occasion, it was explained by the Government that those technical specifications, such as MIL–D–27113, which were specifically called out in Exhibit A (the basic statement of work) "will be contract requirements," whereas those specifications that were referred to only in the technical specifications but not in Exhibit A—for example, MIL–R–26474—were "to insure adequate design considerations and component quality for the elements that make up each equipment." It is on the basis of this answer or explanation, coupled with the absence of any mention of MIL–R–26474 in its technical proposal, that the contractor made the argument before the Board that it was not obliged to meet the requirements spelled out in MIL–R–26474.

The argument is frivolous. The contention that MIL–R–26474 was intended to serve simply as a design objective or goal rests on a strained interpretation of the answer which the Government gave at the bidders' conference. The contract required adherence to MIL–D–27113 and that necessarily meant adherence to all the specifications that it incorporated. To read the Government's answer otherwise is to diminish the very purpose which the Government had identified with those incorporated specifications—the assurance of adequate design and component quality.

As to the contention that the contractor's proposal did not specifically mention or promise compliance with MIL–R–26474, this point is also without substance. In Librascope's technical proposal, under the heading of "Quality Assurance Compliance," it was stated that "[t]he Contractor agrees to the inspections and tests required by paragraph 4 of MIL–D–27113." The latter, *i.e.*, paragraph 4

of MIL–D–27113, specifically stated that the equipment was to be subjected to preproduction tests including reliability testing performed "in accordance with MIL–R–26474."

Claim 10.e

This claim was called out in plaintiff's petition but the briefs which plaintiff submitted offer no discussion of this claim. We assume, therefore, that the claim has been abandoned.

Claim 11
Interest Costs

The contractor claimed that, as part of an equitable adjustment in contract price, it was entitled to the reimbursement of interest costs associated with borrowings allegedly undertaken to finance the changes in issue. The Board denied the claim on the ground that a "necessity for borrowing" had not been shown. We agree with the Board's result, but, in light of the argument that plaintiff raises here, find it necessary to expand upon what the Board has said.

In the development of its case before the Board, plaintiff showed that all the cash that it required in the performance of the instant contract was borrowed from its parent corporation, General Precision, Inc. and this parent, in turn, received its cash requirements from its own parent corporation, General Precision Equipment Corporation. It was further shown (and the Board so found) that General Precision Equipment Corporation supported[9] the cash demands necessary for all three operations (*i.e.*, its own separate activities as well as the activities of its subsidiary and those of Librascope) by borrowing from banks and other lending institutions. The operative relationship among the three corporations was described by the Board in these terms:

[9] The word "supported" is the Board's own. In light of the evidence, we take this to mean that some portion of total corporate cash demand derived from borrowing. The record does not support the idea that *all* of General Precision Equipment Corporation's cash requirements stemmed from borrowing.

> Appellant [Librascope] would be advanced money by General Precision Inc. for all its operations to use as operating capital at the beginning of the year without regard to specific jobs or anything of that nature * * *. In addition, the cash generated by Librascope Division would not be retained for its own use but rather returned and then received again from the corporate parent. * * * A similar practice was in effect between General Precision Incorporated and General Precision Equipment Corporation. [73–2 BCA at 48,425; transcript citations omitted.]

Thus, because of the pass-through arrangement described previously, the ultimate source of Librascope's funds was the borrowings of General Precision Equipment Corporation. And, in light of that relationship, the Board observed that "it is interest on the borrowings of General Precision Equipment Corp. that we are concerned with under this claim." (73–2 BCA at 48,425.)

In the argument that we are now asked to consider, the contractor invokes a rule to which this court and the contract boards have adhered: interest, absent its specific prohibition by contract or applicable procurement regulation, is recoverable as part of an equitable adjustment where the proof shows it to be a cost incurred in connection with monies required to be borrowed in order to finance a change in the contract. Traditionally, two types of factual situations have been encountered: those involving a specific loan undertaken in order to finance the changed work, *see, e.g., Bell* v. *United States*, 186 Ct. Cl. 189, 404 F.2d 975 (1968); *Aeronca Manufacturing Corp.*, ASBCA No. 9173, 69–2 BCA ¶ 7811, and those involving contractors whose business practices included a course of borrowing from lending institutions. In the latter situation, the allowance of interest depended upon a specific showing that the course of borrowing was affected by the change in question, *i.e.*, that apart from the normal borrowing pattern, there was a necessity to borrow specifically due to the change in question. *Aerojet-General Corp.*, ASBCA No. 17171, 74–2 BCA ¶ 10,863. Though apparently not spelled out in the Board decisions, we perceive the reason for the last-mentioned requirement to be the need to provide for an identity of treatment between the contractor who relies

upon his own equity and one who borrows generally. As to each, interest is a recoverable cost only to the extent that such interest is shown to be attributable to the need to finance additional work (or other extra costs incurred because of Government action) not contractually required at the outset of performance.

In this case, as we have already noted, the Board denied the interest claim because the proof failed to show a necessity for borrowing. Two points are said to invalidate this conclusion. First, it is claimed that the contractor's necessity for borrowing is established by the fact that Librascope was entirely dependent upon outside funds. Consequently, any increase in Librascope's cash needs necessarily spelled out a corresponding need for an increase in its borrowing. Second, it is claimed that essentially the same constraints operated at the level of General Precision Equipment Corporation—the ultimate funding source for Librascope. That company's outstanding indebtedness during the 3-year period in question, 1962–64, was in the area of $50,000,000 annually[10] and, in view of that magnitude of borrowing, it is claimed that no idle funds would have existed with which to support Librascope's own substantial cash needs. We are asked to take judicial notice of the fact that in large corporations "[i]ncome in the form of cash is virtually immediately used to reduce a company's short term debt or invested in short term securities such as treasury notes. Cash is simply not allowed to remain idle because of the same considerations involved in this claim: it is recognized that interest charges are a significant cost of doing business." In essence then, the second argument is that when Librascope had to borrow, its funding source also had to borrow.

The first argument is factually correct but legally irrelevant. Librascope's own necessity for borrowing is of no concern in this case because it was, in reality, nothing more than a cost center—it operated without any funds of its own and retained none of the profits that it generated.

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[10] The specific figures found by the Board were as follows: 1962 - $50,522,000; 1963 - $60,228,000; and 1964 - $49,844,000. The exhibit from which these figures were taken does not show the nature of the indebtedness, *i.e.*, whether long term or short term. The exhibit reports only that these figures included "mortgages payable."

Its financial dealings were entirely intra-corporate; the interest obligation that it incurred was, in the last analysis, the obligation of General Precision Equipment Corporation.

The contractor's second argument requires more discussion. In its decision, the Board said that it was "apparent that the cash flow position of General Precision Equipment Corp. is such that its 'course of borrowing' could not possibly have been affected by the changed work." (73–2 BCA at 48,425.) Accordingly, the Board found that the requisite necessity for borrowing had not been demonstrated. Although we agree with the Board's result, we cannot endorse the reasoning behind it.

So far as we can tell, there is nothing in the record that would have permitted the Board to say what it did about the cash flow position of General Precision Equipment Corporation. Indeed, the absence of any proof on this point is fairly evident from the fact that the contractor now asks that we take judicial notice of the fact that large corporations do not maintain idle cash. However, even if we were to enlarge the proof in the manner suggested, it would not overcome the real problem in this record, namely, the lack of any meaningful evidence concerning the course of borrowing that was followed by General Precision Equipment Corporation. For example, the record does not disclose the nature of the various transactions that comprised the total of that company's annual indebtedness (its course of borrowing), it does not disclose the company's cash position or the changes in that position during the 3-year period in question nor does it disclose the manner in which Librascope's capital demands were satisfied by General Precision Equipment Corporation—whether by cash (surplus), by new borrowings or simply by extending past borrowings through added interest payments. Without this type of information, it would be for us nothing more than speculation to accept the contractor's position—that every increase in total corporate cash demand generated a corresponding increase in interest owed. The record as it stands leaves unanswered the point that matters most: that reasonable business needs dictated a necessity for borrowing in order to finance the compensa-

ble changes that occurred during Librascope's performance of its 473–L contract.

The contractor tells us that this case is on all fours with the decision in *Aerojet-General Corp., supra,* where interest was recovered for the increase in borrowings brought on by the Government's failure to timely make available contractually-required progress payments. Perhaps in broad outline the claimed identity does exist but the cases part on their proof. That case offered what this case does not: specific and detailed evidence showing in positive fashion that, as a consequence of the Government's action, the corporation's short term borrowing needs were increased. Had we such information in this case, the result would obviously be different.

One final observation is in order. The argument for the recovery of interest that the contractor presented to the Board and to this court was based upon the traditional notion that interest represents a cost item whose allowance as part of an equitable adjustment requires proof of a specific loan or proof of a necessity for borrowing. Thus, while we note that the Armed Services Board of Contract Appeals has recently taken what appears to be a new direction in the treatment of interest claims, *see New York Shipbuilding Co.,* ASBCA No. 16164, 76–2 BCA ¶ 11,979 (allowing interest as an element of profit based upon the imputed value of the equity capital which the contractor had used in financing the changes in issue), our present decision intends no comment upon that recent Board decision. The arguments made there were not raised here and our treatment of the interest issue in this case was limited accordingly. The interest claim is denied because the necessity for borrowing *by General Precision Equipment Corporation* was not proven.

Claim 12
Claim Preparation Costs Including Attorneys' Fees

In this claim the contractor seeks recovery, by way of an equitable adjustment in contract price, for the attorneys' fees, technical consultants' fees, and in-house personnel costs that were incurred in connection with the prepara-

tion and documentation of the claims for equitable adjustment that it presented to the contracting officer. The Board denied this claim, saying:

> It is clear from the facts that the costs in question were not incidental to performance of work or alleged changes but were incidental to a claim. That the claim was to the contracting officer for an equitable adjustment rather than to this Board for the same relief is not significant. [73–2 BCA at 48,426.]

We agree with the Board's decision.

The contractor does not dispute the proposition that legal fees associated with the prosecution of a claim before a contract board are not recoverable. Such fees fall within the statutory prohibition of 28 U.S.C. § 2412 (1970). Except as otherwise provided by statute, that section permits costs to be taxed against the United States, "but not including the fees and expenses of attorneys" in any civil action brought by or against the United States or any agency or official of the United States acting in an official capacity. Mindful of this restriction, the contractor contends here that the legal fees and other claim-related fees that it seeks are not litigation-connected but are, instead, expenses incidental to contract performance. In support of this contention, the contractor relies upon the decision in *Allied Materials & Equip. Co.*, ASBCA No. 17318, 75–1 BCA ¶ 11,150. That case, says Librascope, permitted recovery of legal fees incurred in connection with the preparation and presentation, to the contracting officer, of a request for equitable adjustment. And, in so doing, argues the contractor, the *Allied* decision implicitly overruled such earlier decisions as *Power Equipment Corp.*, ASBCA No. 5904, 1964 BCA ¶ 4025, *aff'd on reconsideration*, 1964 BCA ¶ 4228, which viewed requests for equitable adjustments (and the attorneys' fees associated therewith) as the equivalent of claims prosecution rather than contract performance.

It is not disputable that the Board in *Allied* did allow the recovery of the attorneys' fees connected with an equitable adjustment request made to the contracting officer. But, to say that in doing so the Board thereby intended to or actually did depart from prior law is to misread the

decision. The equitable adjustment involved in that case addressed a situation where the contractor's entitlement to the requested relief was well-nigh conclusive—the equitable adjustment was intended to compensate the contractor for the added performance costs attributable to the Government's *acknowledged* failure to have made available the facilities and tooling that had been promised at the outset. Joined with this was the equally important fact that the request for equitable adjustment occurred in the midstream of contract performance and had, as one of its principal objects, the development of a new production schedule to accommodate the delays which the Government's own actions had provoked. In short, the objective of the equitable adjustment in *Allied* was twofold: to pay the contractor what was owed in a situation where Government liability was not disputed and to ascertain the course of future performance with a view to securing the objective for which the contract had been let in the first place. The Board in *Allied* saw the situation no differently. It said:

> In the instant case with the sale of the Government-owned plant and the machine tools involved there was never a question of the Government's liability under the supply contract. The request for an equitable adjustment was on its face meritorious and, of course, it was incumbent in the first instance for the appellant to propose the details of the adjustment with respect to a new delivery schedule to accommodate the delay provoked by the Government action, to propose the price adjustment because of the subjective impact of such action upon the appellant, to propose a new plan of production and to alter the related terms of the contract. * * * That the appellant under the circumstances retained an attorney to present the adjustment was a prudent business decision and a reasonable one. * * *
>
> Whatever the demarcation line may be between the ordinary interchanges between a supplier and the Government as a customer which have inherent differences in point of view and a claim against the Government, we are satisfied in the facts before us that conflict between the parties as to the equitable adjustment never became so disputatious as to reach the level of a claim against the Government * * *. [75–1 BCA at 53,087.]

Plainly, the situation presented in the instant matter differs significantly from that encountered in the *Allied*

case. Here, the claims for equitable adjustment were not presented to the contracting officer until all work had been completed, they addressed no situation in which Government liability was clear or apparent and, in content, they offered nothing that could reasonably be considered as benefiting the contract purpose. Judged both from the standpoint of the time of their submission and the purpose of their submission, Librascope's requests for equitable adjustment were not performance-related; they bore no beneficial nexus either to contract production or to contract administration. Accordingly, the attorneys' fees are not recoverable. As to the other claim preparation costs which plaintiff also seeks, these too are not allowable and for the same reason—they bear no relation to contract performance.

Claim Concerning Allowability of Plaintiff's Requested Costs

Librascope's final claim is that in determining quantum *on the claims in issue in this appeal,* we should adhere to the costing approach that the contractor relied upon rather than upon the adjustments to that approach which the Board used on those claims which it allowed. Since we find that the contractor is not entitled to recovery on any of the claims raised by this appeal, the contractor's disagreement with the Board's pricing technique becomes a moot question.

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568 F.2d 192

JOHN D. HOLLINGSWORTH, JR. v. THE UNITED STATES

[Nos. 115–72 and 283–74. Decided December 14, 1977]

ON PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT AND DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT

Taxes; income tax; deductions; taxable year of deduction; retroactive change in accounting from cash to accrual method; contested liability; interest, time for deducting.—Plaintiff, sole owner and

Syllabus

operator of a textile machinery manufacturing plant, seeks to recover asserted overpayments of federal income taxes for calendar years 1962 and 1963, plus statutory interest. Through 1963 plaintiff reported business income using the cash method of accounting despite the presence of substantial inventories and accounts receivable. Investigations by South Carolina and federal agents also revealed that plaintiff's business expenses had been substantially overstated for certain years. The state tax commission proposed a change in accounting from a cash to accrual method beginning in 1959, and the disallowance of overstated expense deductions for 1960–1962. After protesting the proposed adjustments, plaintiff in 1966 and 1967 paid the state income tax deficiencies, interest and a negligence penalty. The Internal Revenue Service also proposed the same change in accounting effective January 1, 1960, and the disallowance of substantially overstated claimed expense deductions. Plaintiff protested asserting, *inter alia*, that in view of the Service's proposal to change his method of accounting he should be permitted to accrue certain state income tax deficiencies and interest thereon, and interest on federal income tax deficiencies in the years to which they related. Plaintiff did not protest the Service's proposed change in accounting method. After lengthy negotiations, in December 1971 plaintiff agreed to a stated deficiency figure, interest and fraud penalties, based on said change in accounting method (effective January 1, 1962), and disallowance of certain expense deductions. In the closing agreement, plaintiff expressly reserved the right to file claims and sue for refund on the ground of entitlement to accrue as deductions certain state tax deficiencies and interest on federal and state tax deficiencies. Upon disallowance of federal claims for refund, the present actions were filed on the basis of plaintiff's reservation. It is *held* that plaintiff is not entitled to deduct state income tax deficiencies and interest thereon in the years to which they related since plaintiff's protest to the state tax commission rendered his liability contingent and contested. It is also *held* that plaintiff may accrue and deduct interest on his federal tax deficiencies in the years to which the deficiencies related. Plaintiff's motion for summary judgment is granted in part and denied in part, defendant's opposition to plaintiff's motion on the ground that a material issue of fact exists is overruled and defendant's motion for partial summary judgment is denied in part and granted in part. Judgment is entered that plaintiff is entitled to recover and the case is remanded to the trial division for further proceedings under Rule 131(c).

Taxes; income tax; deductions; taxable year of deduction; accrual basis taxpayer; contested liability.

[1] Where a taxpayer is required by the Service retroactively to change his method of accounting from a cash to accrual method, under the "all events" test embodied in Treas. Reg. § 1.461–1(a)(2), his right to accrue otherwise properly deductible expenses may nonetheless be deferred beyond the year or years to which such deductions relate if his objective acts are inconsistent with recognition of the relevant liability. Where liability is contingent and is contested by a taxpayer, there is no right to

Syllabus

accrue that liability in the taxable year in which it would, absent contest, be deductible.

Internal Revenue ⚖574

Pleading and practice; defenses; affirmative defense; when and how presented.

[2] While under Rule 37(b) the defense of fraud must be affirmatively pleaded, where defendant has argued the defense in its brief and plaintiff has not objected to defendant's failure to plead affirmatively, the court will consider the defense on the merits.

Federal Courts ⚖1111

Taxes; income tax; deductions; taxable year of deduction; accrual basis taxpayer; contested liability; fraudulent return.

[3] Mere fraud in the filing of a state or federal income tax return does not create a contingency and contest by a taxpayer so as to require deferral, under the "all events" test of accrual, beyond the taxable year to which later determined deficiencies and interest thereon otherwise properly relate.

Internal Revenue ⚖691

Taxes; income tax; deductions; taxable year of deduction; contested retroactive change in accounting method.

[4] Where a state tax commission proposed to change taxpayer's method of accounting from cash to accrual which would result in state income tax deficiencies and interest thereon, and taxpayer made a direct and substantial challenge to the change on the ground that he was entitled in the tax years in issue to remain on a cash basis, taxpayer thereby rendered his liability for the deficiencies and interest contingent and contested within the meaning of the "all events" test of Treas. Reg. § 1.461–1(a)(2). Under such circumstances, accrual of the liability in the taxable years in which they would have been deductible, absent contest, is improper.

Internal Revenue ⚖691

Taxes; interest; time for deducting interest; accrual basis taxpayer; interest on contested taxes.

[5] A taxpayer who was required to change from cash to accrual accounting and who contested the federal income tax deficiencies resulting from the change, is entitled to accrue and deduct the interest on such deficiencies in the years to which the deficiencies related; a contention that the statute of limitations had run on the challenged deficiencies did not constitute a "contest." The possibility that a present liability may subsequently be discharged by some condition subsequent does not prevent its accrual on a taxpayer's books, the test being whether the accrual basis taxpayer is justified in believing that an absolute liability will be incurred.

Internal Revenue ⚖518

Per Curiam

Taxes; income tax; accounting method; change in accounting method; contest of liability for state tax deficiencies; effect of contest on federal liability.

[6] Denial of the validity or accuracy, or both, of an asserted liability to the person who is asserting such liability is essential to the concept of a "contest" which would prevent accrual of a liability under Treas. Reg. § 1.461a. Thus, an argument to a state tax commission that taxpayer was entitled to continue to use the cash method of accounting and not the accrual method proposed by the commission, cannot be deemed a contest of a liability asserted by the federal government.

Internal Revenue ⊂⇒691

Randolph W. Thrower, attorney of record, for plaintiff. *Sutherland, Asbill & Brennan,* of counsel.

Kenneth R. Boiarsky, with whom was *Assistant Attorney General M. Carr Ferguson. Theodore D. Peyser* and *Donald H. Olson,* of counsel.

Before LARAMORE, *Senior Judge,* KUNZIG and BENNETT, *Judges.*

PER CURIAM: These cases come before the court on requests by both plaintiff and defendant, for review by the court of the recommended decision of Trial Judge Harry E. Wood, filed November 3, 1976, pursuant to Rule 54(a), on plaintiff's motion for summary judgment and defendant's cross-motion for partial summary judgment. Upon consideration thereof, together with the briefs and oral argument of counsel, since the court agrees with the trial judge's recommended decision, as hereinafter set forth,* it hereby affirms and adopts the decision with minor modifications (see footnotes 13 and 14) as the basis for its judgment in these cases. Therefore, in accordance with the decision, plaintiff's motion for summary judgment is granted in part and denied in part, defendant's opposition to plaintiff's motion for summary judgment on the ground that a material issue of fact exists is overruled and defendant's motion for partial summary judgment is denied in part and granted in part. Judgment is entered that plaintiff is entitled to recover and the case is referred to the trial division for further proceedings pursuant to Rule 131(c).

* The necessary facts are stated in the opinion.

OPINION OF TRIAL JUDGE

WOOD, *Trial Judge:* In these consolidated cases, plaintiff sues for the recovery of asserted overpayments of federal income taxes for the calendar year 1962 in the amount of $894,732, and for the calendar year 1963 in the amount of $526,489,[1] together with interest thereon as provided by law.

Plaintiff's motion for summary judgment, and defendant's cross-motion for partial summary judgment, have been referred to the trial judge, pursuant to Rule 54(a), for his opinion and recommendation for the conclusion of law.

I

Effective January 1, 1962, under circumstances to be described, plaintiff[2] was required by the Commissioner of Internal Revenue to change his method of accounting for business income from the cash receipts and disbursements method ("cash method") to the accrual method. In broad (if perhaps oversimplified) terms, plaintiff contends that in the circumstances of this case he is entitled to deductions, in the years 1962 and 1963, for state income tax deficiencies attributable to business income, and for interest on state and federal income tax deficiencies attributable to business income, determined in accordance with the accrual method of accounting, and not, as defendant insists, in later taxable years.

In opposing plaintiff's motion for summary judgment, defendant contends that "the presence of fraud in the submission of state and federal income tax returns constitutes a contest with respect to any later determined

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[1] The asserted 1962 overpayment does not include "interest erroneously assessed and paid thereon", while the asserted 1963 overpayment does include some $166,515 assessed and paid as interest.

[2] Plaintiff and his former wife filed a joint federal income tax return for the year 1962. On July 18, 1975, the court allowed defendant's motion for leave to reserve the right to join plaintiff's former wife "as a party to this action to assert any interest she may have in the event that a recovery for the 1962 joint-return year in issue is in excess of the amounts which may be credited against joint tax liabilities for other years." While plaintiff did not object to allowance of defendant's said motion, he did respond that he saw "no foundation for Defendant's suggestion of further complexity of this sort in the case."

deficiencies, and interest thereon, relating to those returns"; that "a question of fact sufficient to require remand exists with respect to whether the state and federal returns filed by or on behalf of the taxpayer were fraudulent"; and that, accordingly, plaintiff's motion for summary judgment should be denied.

Defendant also contends, however, that it is entitled to partial summary judgment in any event, since, in defendant's view, plaintiff "contested" liability for substantial portions of state income tax deficiencies and interest thereon, and certain federal income tax deficiencies, in 1962 and 1963, thus rendering his liabilities for such state income tax deficiencies, and interest thereon, and for interest on such federal deficiencies, "contingent". Accordingly, defendant asserts, the "contested" liabilities plaintiff now seeks to accrue as deductions in those years may not be taken in 1962 or 1963, but rather must be deferred "until [later years, when] liability was either conceded or paid."

II

The factual background out of which this litigation arises, as derived from the pleadings, exhibits, and affidavits of the parties, is lengthy, complex, strange, and fascinating. For present purposes, however, only those facts essential to resolution of the issues raised will be set forth herein.

For some years prior to, and during, the years 1962 and 1963, plaintiff operated, as a sole proprietorship, a textile machinery manufacturing, rebuilding, and repairing service located in Greenville, South Carolina. Beginning about 1959, largely as a result of plaintiff's development of a method of producing and applying an improved "metallic clothing" (a covering, or clothing, used in carding machines) to carding machine rolls, and of insuring that the improved metallic covering met the particular specifications and requirements of each textile mill that used it, plaintiff's theretofore relatively modest business grew

rapidly in volume, becoming a large and profitable operation with annual receipts of millions of dollars.

For many years prior to 1959, plaintiff's former wife had served as office manager of the business, was in charge of keeping such books and records as were maintained by it,[3] handled its financial affairs, and prepared and filed its tax returns. Although plaintiff's former wife had had no formal training in accounting or finance, she continued, during the 1959–63 period, to serve as office manager, and was in charge of the administrative, financial, and accounting aspects of the business, including the preparation and filing of tax returns. Despite the rapid and considerable growth that occurred during the said period, no accounting, legal, banking, or other professional advice and assistance was obtained.

For the years 1960–62, plaintiff's former wife prepared and filed (and signed plaintiff's name to) joint federal and state income tax returns. Plaintiff and his former wife had begun to experience severe marital difficulties during those years, however, and by the fall of 1963 their relationship had deteriorated to a critical point. Plaintiff's former wife ceased being active in the business in September 1963. In January 1964 they separated, and litigation, resulting in a divorce in 1969, was commenced. Plaintiff's separate 1963 federal and state income tax returns were prepared and filed by a certified public accountant.[4] Through 1963, the income from the operation of plaintiff's business was reported on all such returns on the cash method.

In May 1964, agents of the South Carolina Tax Commission ("Commission") began an investigation of plaintiff's income tax returns, and late in 1964, revenue and special agents of the Internal Revenue Service ("Service") also began an extensive investigation into such income tax returns. The state investigation related to the tax years 1959 through 1963; the federal investigation related to the tax years 1960 through 1963.

During the course of their respective investigations, both the state and the federal agents looking into plaintiff's

[3] The business kept no books and records in the normal sense of those words.

[4] Plaintiff also retained an attorney in 1964 in connection with the preparation and filing of his 1963 state and federal income tax returns.

income tax liability discovered (and plaintiff's representatives acknowledged) the presence of substantial inventories and accounts receivable.[5] Among other things, both the state and the federal agents also learned (and plaintiff's representatives also acknowledged) that plaintiff's business expenses had been substantially overstated for the years 1960 through 1962.

By letter dated February 26, 1965, the Commission proposed adjustments to plaintiff's state income tax liability, for the years 1959 through 1963, of (in round figures) $1,660,000, consisting of some $605,000 in taxes, $450,000 in interest, and a 100 percent fraud penalty. The principal bases for the proposed adjustments in taxes were a change of plaintiff's method of accounting from cash to accrual (which the state proposed to make effective in 1959), and the disallowance of substantially overstated expense deductions claimed for the years 1960 through 1962.

In March 1965, plaintiff submitted a protest to the Commission with respect to the adjustments proposed by the Commission February 26, 1965. On May 31, 1965, the Commission held a hearing in the matter. The nature of plaintiff's protest, and its present significance, will be discussed hereinafter. Section V(A), *infra*. For present purposes, it suffices to state that by letter dated November 30, 1965, the Commission proposed adjustments to plaintiff's state income tax liability for the years 1959 through 1963 of (in round figures) $2,260,000, consisting of some $785,000 in taxes, $690,000 in interest, and a 100 percent fraud penalty.

In February 1966 plaintiff submitted a revised protest to the Commission with respect to the adjustments proposed by it November 30, 1965. That protest, also treated hereinafter, seemingly met with at least partial success. In 1966 and 1967, plaintiff paid to the State of South Carolina, state income tax deficiencies, for the years 1959 through 1963, of some $785,000, plus accumulated interest thereon of some $416,500. The proposed 100 percent fraud penalty was, however, reduced to a negligence penalty of 5 percent.

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[5] Plaintiff's total inventory and accounts receivable for the years 1960–63 ranged (in round figures) from a low of $3,300,000 in 1960, to a high of $8,000,000 in 1963.

Because of the complexity of the situation, the federal investigation (which included the possibility of prosecution for criminal fraud) moved more slowly. In August 1968, however, a tentative Revenue Agent's Report was delivered to plaintiff's accountant for review and comment.[6] That tentative report, covering the joint tax liability of plaintiff and his wife for the years 1960 through 1962, and plaintiff's separate tax liability for 1963, proposed against plaintiff federal income tax deficiencies of some $11,200,000, plus fraud penalties of some $5,600,000. The principal bases for the proposed deficiencies were, again, a change of plaintiff's accounting method from cash to accrual (effective January 1, 1960) and the disallowance of substantially overstated expense deductions claimed.

Following August 1968, plaintiff's accountant continued to work closely and extensively with the Service. On March 9, 1970, a Revenue Agent's Report, proposing deficiencies in federal income tax (for the years 1960 through 1963) of some $10,750,000, plus fraud penalties of some $5,350,000, plus interest, was issued. Plaintiff (through his accountant) acquiesced in some of the Service's proposed adjustments, but took exception to certain others.

On July 30, 1970, plaintiff filed a written protest with the Appellate Division of the Service, asserting, among other things, that in view of the Service's proposal to change his method of accounting from cash to accrual, he should be permitted to accrue certain state income tax deficiencies and interest thereon, and interest on federal income tax deficiencies, "in the years to which they relate"; that he was entitled to a deduction in 1963 for an embezzlement loss as claimed; that he should not be subjected to fraud penalties for any of the years 1960 through 1963; and that the limitation period on assessment had expired for the years 1960 and 1961, thus barring collection of any portion of the Service's proposed deficiencies for those years.[7] Among other things, plaintiff did not

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[6] Plaintiff's accountant had worked closely with the Service in determining the extent of plaintiff's federal income tax liability, and knew approximately what the income adjustments would be long before being formally advised of them.

[7] Claimant submitted a supplemental memorandum on the limitation aspect of the matter October 19, 1971.

protest the Service's proposed change of his method of accounting from the cash to the accrual method,[8] its disallowance of certain overstated business expense deductions, and its position respecting his failure to capitalize certain expenditures.

In December 1971, after lengthy and complex negotiations, a Closing Agreement was executed by plaintiff and duly accepted for the Service. In the said Closing Agreement, plaintiff agreed to total deficiencies, plus interest and fraud penalties, of more than $8,725,000 for the years 1960 through 1963. The principal bases for the agreed deficiencies were a change in plaintiff's method of accounting from the cash to the accrual method effective January 1, 1962, and the disallowance of the substantially overstated expense deductions claimed for the years 1960 through 1962.

In the Closing Agreement, the net amount of the agreed deficiency for the year ended December 31, 1962, was determined without taking into account "state income taxes and interest on state and federal income tax deficiencies attributable to taxable years ended prior to January 1, 1962 which were unpaid as of January 1, 1962." Nor was plaintiff allowed a deduction in the years 1962 or 1963 for any state tax deficiencies, or for any interest on state and federal tax deficiencies, attributable to each such taxable year. In the Closing Agreement, however, plaintiff expressly reserved the right to file claims for (and, if necessary, to sue for) refund, on the ground of his entitlement to accrue as deductions such state tax deficiencies, and interest on federal and state tax deficiencies, in the years 1962 and 1963. Plaintiff's timely claims for refund for 1962 and 1963 were disallowed, and these actions followed.

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[8] As defendant asserts, in a letter dated September 20, 1971, to the Service, concerning administrative settlement of this matter, plaintiff's attorney did suggest that it would be "reasonable and just" to make the change to the accrual method effective January 1, 1963. As noted, however, plaintiff's formal protest of July 30, 1970, did not question the Service's right to make the change, nor did it question the proposed effective date thereof.

III

Treas. Reg. § 1.461–1(a)(2) (1970), originally promulgated in 1957,[9] provides in part that:

> *Taxpayer using an accrual method.* Under an accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred which determine the fact of the liability and the amount thereof can be determined with reasonable accuracy. * * * While no accrual shall be made in any case in which all of the events have not occurred which fix the liability, the fact that the exact amount of liability which has been incurred cannot be determined will not prevent the accrual within the taxable year of such part thereof as can be computed with reasonable accuracy. * * *

It is here undisputed that a taxpayer like plaintiff, who is required by the Service retroactively to change his method of accounting from the cash to the accrual method, is, in general terms, entitled, in employing such accrual method, to deductions for his expenses, including taxes and interest, in the years to which those expenses relate under fundamental principles of accrual tax accounting, even though such expenses may not, in fact, have been paid in such years. *United States* v. *Anderson*, 269 U.S. 422, 440–41 (1926). See also *Eastman Kodak Co.* v. *United States*, 209 Ct. Cl. 365, 534 F.2d 252 (1976); *Dravo Corp.* v. *United States*, 172 Ct. Cl. 200, 348 F.2d 542 (1965). In such circumstances, where an additional tax liability for a prior year is asserted by the Service, and that liability is not "contingent and * * * contested", all events necessary to determine the fact and the amount of that liability will be deemed to have occurred in the year to which the liability related, notwithstanding the taxpayer's failure to acknowledge the liability in the prior year. *Dixie Pine Products Co.* v. *Commissioner*, 320 U.S. 516, 519 (1944); *Dravo Corp.* v. *United States*, *supra*.

It is also clear, however, that under the "all events" test established in *United States* v. *Anderson*, *supra*, and embodied in Treas. Reg. § 1.461–1(a)(2), such a taxpayer's right to accrue otherwise properly deductible expenses may

[9] T.D. 6282, 22 F.R. 10686, December 25, 1957.

nonetheless be deferred beyond the year or years to which such deductions relate, if, as defendant puts it, "the taxpayer's objective acts are inconsistent with recognition of the relevant liability, that is, * * * the liability is contested * * *." See *Security Flour Mills Co.* v. *Commissioner,* 321 U.S. 281 (1944); *Dixie Pine Products Co.* v. *Commissioner, supra.* Where "liability is contingent and is contested by the taxpayer", there is no right to accrue that liability in the taxable year in which it would, absent contest,[10] be deductible. *Dixie Pine Products Co.* v. *Commissioner, supra.*

IV

For purposes of these actions only, defendant concedes that unless the state income tax deficiencies, and interest on state and federal income tax deficiencies, which plaintiff claims the right to accrue as deductions for 1962 and 1963, "represent contested liabilities, they are deductible as trade or business expenses in determining taxable income for 1962 and 1963."[11] As defendant sees it, the "only issue in these actions is whether these items are deductible in 1962 and 1963 (the years to which they relate), or whether, because * * *" plaintiff contested liability therefor, the deductions may be claimed only after the tax years here in suit.

As noted at the outset, defendant opposes plaintiff's motion for summary judgment on the grounds that the presence of fraud in the submission of state and federal income tax returns constitutes a contest with respect to

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[10] Treas. Reg. § 1.461–2(b)(2) (1970), promulgated in T.D. 6772, 29 F.R. 15753, November 24, 1964, provides in pertinent part that a "contest arises where there is a bona fide dispute as to the proper evaluation of the law or the facts necessary to determine the existence or correctness of the amount of an asserted liability." While the institution of court action is not necessary in order to contest an asserted liability, "An affirmative act denying the validity or accuracy, or both, of an asserted liability to the person who is asserting such liability * * *" is. *Ibid;* see also *Dixie Pine Products Co.* v. *Commissioner, supra.*

[11] In its reply brief, defendant suggests that this concession does not refer to "a 'contest' in the technical sense of that word", but rather should be read "to be a concession of deductibility only if there is neither a 'contest' nor any other contingency which would prevent satisfaction of the controlling 'all events' test." In this case, the difference defendant thus purports to see is in fact merely semantic.

any later determined deficiencies, and interest thereon, relating to those returns, and that, on the record presently before the court, there is a genuine issue of fact whether the 1959–63 state and 1960–62 federal income tax returns filed by or on behalf of plaintiff were fraudulent. Thus, defendant concludes that denial of plaintiff's motion for summary judgment, and remand for trial, are required.

Rule 37(b) of the Rules of this court requires that in pleading to a preceding pleading a party "shall set forth affirmatively * * * fraud * * *." See also Rule 33(b). Defendant's answers in these cases, filed June 22, 1972, and October 4, 1974, respectively, do not plead fraud. See Rule 38(h). Nor has defendant filed a motion for leave to amend its answers herein. *Cf. Hess* v. *United States*, 210 Ct. Cl. 483, 537 F.2d 457 (1976), *cert. denied*, 430 U.S. 931 (1977); *Cities Service Helex, Inc.* v. *United States*, 211 Ct. Cl. 222, 234 n. 14, 534 F.2d 1306, 1313 n. 14 (1976). In light of plaintiff's lack of objection to defendant's failure to plead fraud affirmatively, and the court's decision in *Hess*, however, it seems appropriate to reach the substance of defendant's arguments.

What plaintiff does contend, with vigor, is that even assuming a fraudulent attempt, in the filing by or on behalf of plaintiff of state or federal income tax returns, to evade income tax liability, such an attempt would not constitute a "contest" of such liability. Plaintiff also contends, however, that defendant is in any event foreclosed by the 1971 Closing Agreement from raising the issue of fraud in the instant matter.[12]

In *Dravo Corp.* v. *United States*, *supra*, the taxpayer filed a 1953 capital stock tax return with the Commonwealth of Pennsylvania, and the stock valuation reflected in that return was accepted. In 1956, however, the Commonwealth reviewed the 1953 return and, in consequence, increased the capital stock tax attributable to 1953 by some $32,000. The taxpayer paid the additional tax without appeal or

[12] Plaintiff adds that, should fraud be deemed a "contest" and the issue of fraud not be foreclosed, he would vigorously defend the position that neither he nor his former wife was guilty of fraud in the filing of their joint federal income tax returns for 1960–62, and that his 1963 separate returns, filed by his accountant, could under no circumstances justifiably be characterized as fraudulent.

protest, filed a claim for refund of federal income taxes for 1953 on the ground that the additional tax attributable to 1953 was deductible in that year, and, when its claim for refund was disallowed, sued defendant to recover (among other things) the resulting asserted overpayment.

In this court, in an effort to prevent accrual of the additional tax attributable to 1953 in that year, pursuant to the refinement added to the "all events" test in *Dixie Pine Products Co.* v. *Commissioner, supra,* defendant argued "that the mere filing of a state tax return acknowledging a liability in a stated amount is a 'contest' since that entails a denial by the taxpayer that it owes an amount of tax greater than that specified on the return." *Dravo Corp.* v. *United States, supra,* 172 Ct. Cl. at 206, 348 F.2d at 545.

In holding for the taxpayer, the court stated that (*ibid*):

> * * * We do not think it proper to extend the concept of 'contest' to the instant situation where the only basis for such an extension is the taxpayer's subjective motive as to what was intended when a return was filed. If a departure from the traditional concepts of proper accrual tax accounting is required by the fact of contest, [footnote omitted] it should be evidenced by taxpayer's objective acts; *i.e.*, lodging a formal protest with the tax authorities or instituting a suit in a court of law. * * *

See also *National Forge & Ordnance Co.* v. *United States,* 141 Ct. Cl. 880, 158 F. Supp. 860 (1958); *Lutz* v. *Commissioner,* 396 F.2d 412 (9th Cir. 1968); *Woodmont Terrace, Inc.* v. *United States,* 261 F.Supp. 789 (M.D. Tenn. 1966); *Harry Gordon,* 63 T.C. 501 (1975);[13] Treas. Reg. § 1.461–2(b)(2); Rev. Rul. 68–631, 1968–2 Cum. Bull. 198.

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[13] [Footnote by the Court]

The tax court opinion, modifying 63 T.C. 51 (1974), was appealed by the government to the Ninth Circuit Court of Appeals on the ground that the continuing litigation concerning the amount of unreported wagering income prevented the accrual of the excise tax expenses associated with that income. The Ninth Circuit accepted the government's argument and reversed the Tax Court. *Gordon* v. *Commissioner,* 572 F.2d 193 (1977).

We note that the Ninth Circuit was not faced with the specific issue involved in the present case, that is, whether the concealment of transactions is a "contest" for purposes of the "all events" test, but have, nonetheless, weighed the opinion of the Ninth Circuit carefully, We believe that, in the circumstances of the present case, the trial judge's reliance on the result reached and the reasoning employed by the Tax Court was not misplaced, since it appears that the Tax Court decision was more in consonance with our rationale in *Dravo* and with the relevant authorities,

In *Harry Gordon, supra,* the taxpayer was a partner in a company which operated a wagering business in the State of Nevada. There, the Tax Court held that the taxpayer's attempted evasion of taxes, by an unsuccessful effort at concealment of certain wagering transactions, did not constitute a dispute or contest so as to defeat accrual of the excise tax attached to the wagers, in these words (*id.*, at 504–05):

> * * * To construe the regulation under such circumstances to place the income and the directly correlative expense in different taxable years would be unnecessarily and gratuitously to move away from the objective of proper measurement of income. We see no reason to find that the petitioner's attempted concealment of part of the income, reprehensible though that was, constitutes a license to respondent to force upon the [company] an accounting method which does not properly reflect its income. We do not believe that the [company] may defer accrual of an associated expense clearly due and payable, any more than it can defer accrual of the corresponding gross income, merely because petitioner intended to try to conceal the transactions. We are cited to, and find, no authority holding that attempted concealment of a transaction creates a 'dispute' within the meaning of the regulation, and we decline to so hold.

The holding in *Gordon,*[14] the rationale of *Dravo,* and the relevant authorities, regulations, and rulings point clearly to the conclusion that mere fraud in the filing of a state or federal income tax return does not create a contingency and contest, within the meaning of the "all events" test, with respect to later determined deficiencies, and interest thereon, relating to that return.[15] Thus, even assuming the presence of fraud in the submission of plaintiff's state and federal income tax returns, any later determined deficiencies, and interest thereon, relating to the assertedly fraudulent returns, would not thereby be rendered "contingent and * * * contested by the taxpayer" so as to require deferral under the "all events" test of accrual beyond the

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regulations, and rulings.

[14] [Footnote by the Court]
This, of course, refers to the holding of the Tax Court. See note 13, *supra.*

[15] Any such fraudulent activity may, of course, be dealt with effectively. *E.g.,* §§ 6653(b), 7201, Internal Revenue Code of 1954.

taxable years to which they otherwise properly, and admittedly, relate. *Dixie Pine Products Co.* v. *Commissioner, supra; Dravo Corp.* v. *United States, supra; Harry Gordon, supra;* Treas. Reg. § 1.461–2(b)(2); Rev. Rul. 68–631, 1968–2 Cum. Bull. 198.

The conclusion just stated makes it unnecessary to consider either defendant's argument that there exists a genuine issue of material fact with respect to whether plaintiff submitted fraudulent returns to the State of South Carolina for the years 1959 through 1963, and to the Service for the years 1960 through 1962, or plaintiff's assertion that defendant is in any event precluded by the 1971 Closing Agreement from now raising the issue of fraud herein.

Still to be resolved herein are, however, other issues: whether, as defendant also contends, plaintiff's protests to the Commission, or his submissions to the Service, constituted a "contest" of portions of state income tax deficiencies and interest thereon, and interest on federal income tax deficiencies, plaintiff now claims the right to deduct in 1962 and 1963. It is clear from the briefs, however, that should defendant's opposition to plaintiff's motion for summary judgment on the ground that a genuine issue of material fact exists be rejected, as it has been, allowance of plaintiff's motion for summary judgment herein, at least in part, is proper.

Accordingly, and insofar as it is based on the asserted existence of a genuine issue of material fact, defendant's opposition to plaintiff's motion for summary judgment should be denied. To the extent thus opposed on invalid grounds, plaintiff's motion for summary judgment should be granted.

V

Plaintiff's motion for summary judgment herein encompasses, and defendant's cross-motion for partial summary judgment is limited to, certain state income tax deficiencies and interest thereon, and interest on federal income tax deficiencies, claimed as deductions in the years 1962 and 1963. Defendant contends, and plaintiff denies, that plain-

tiff's protests to the Commission, and his submissions to the Service, establish that liability for such state tax deficiencies and interest thereon, and interest on such federal tax deficiencies, were "contested", and are therefore not accruable as deductions in the years to which they would otherwise relate, but must be deferred until later years, when liability was either conceded or paid.

(A) *The Protests to the Commission*

In February 1965, the Commission first proposed adjustments to plaintiff's state income tax returns for the years 1959 through 1963. The said adjustments were primarily based upon a retroactive change in plaintiff's method of accounting from the cash to the accrual method effective January 1, 1959, the disallowance of overstated expense deductions claimed, and the disallowance of a claimed embezzlement loss in 1963.[16]

In March 1965, in a written protest to the Commission, plaintiff protested, among other things, "the proposal to change retroactively the taxpayer's method of accounting from the cash receipts and disbursements basis * * * to the accrual basis," and the "proposed imposition of a 100% penalty * * * and the imposition of additional interest * * *." The March 1965 protest included the assertions that plaintiff's business "was * * * a service organization and as such it was entitled to file its returns on the cash method", and that, even if plaintiff's method of accounting "were to be changed * * * it should not be changed retroactively."[17]

On May 31, 1965, the Commission held a hearing in the matter. At the said hearing, plaintiff's representative stated, among other things, that plaintiff "is entitled to stay on the cash basis method of reporting"; that plaintiff's

[16] While defendant's moving brief suggested that the claimed embezzlement loss deduction was here involved, the record is clear that neither the proposed adjustments attributable to disallowance of overstated expense deductions claimed, nor the proposed adjustment attributable to disallowance of the claimed embezzlement loss in 1963 has any present relevance, for purposes of defendant's cross-motion. Plaintiff did not contest the former proposal, but admittedly did contest, and makes no claim concerning, the latter one.

[17] In February 1966 a revised protest, substantially identical to the earlier one insofar as the retroactive change of accounting method is concerned, was submitted to the Commission. It would appear that as a result of the revised protest the proposed 100 percent fraud penalty was reduced to a negligence penalty of 5 percent.

business "is a service business and * * * that [plaintiff] is entitled to stand on his cash basis method of reporting"; that "it being a service business [the cash method] * * * is a fair method for the taxpayer to be on under all these conditions"; that "* * * our argument that this is a service industry * * * would be difficult for this Commission to disregard"; and that "our fundamental contention [is] that the business was and is, for the years in question, a service business".

Notwithstanding, plaintiff contends that his protest to the Commission was, "in effect, only an appeal to discretion" with respect to the effective date of change of plaintiff's method of accounting from cash to accrual, not a "contest" within the meaning of the "all events" test.[18] There are in the Commission hearing undeniable equitable overtones and arguments. Even assuming, for present purposes, that an "equitable" attack on proposed adjustments would not amount to a "contest", however, it must be and is concluded from the undisputed facts that plaintiff made a direct and substantial challenge to the Commission's proposed change in his accounting method, thereby rendering his liability for state income tax deficiencies, and interest thereon, attributable to such a change "contingent and * * * contested", for purposes of the "all events" test. *Security Flour Mills Co.* v. *Commissioner, supra; Dixie Pine Products Co. v. Commissioner, supra.*

Plaintiff alternatively contends that, even assuming a "contest" of the Commission's proposed retroactive change in his method of accounting, there was no more than a discussion of the question "when the items of revenue affecting the timing of his actual state tax payments would be reported to the state", not his "substantive liability for state income taxes on that revenue." The argument is both ingeniously and beautifully presented, but unpersuasive.

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[18] At one point in the hearing, the Commission stated to plaintiff's representative that "* * * there is no barrier to a real concerted review, I don't suppose, you are suggesting at this date. You aren't suggesting that they have no right at all to do this—you're merely suggesting the hardship involved, as I understand it." Plaintiff's representative replied "That's correct, yes sir." The ambiguous nature of this colloquy aside, plaintiff plainly and repeatedly did assert at the hearing a right "to stay on the cash basis method of reporting".

When plaintiff contested before the Commission portions of his proposed liabilities for state income tax deficiencies, and interest thereon, for the tax years 1959 through 1963, on the ground he was entitled in those years to remain on the cash method of accounting, his actions in so doing rendered contingent and contested his liability for a portion of the sums he would now accrue in the years 1962 and 1963. The relevant authorities teach that in these circumstances accrual of the contested portion of the deductions claimed in such years is improper. *Security Flour Mills Co.* v. *Commissioner, supra; Dixie Pine Products Co.* v. *Commissioner, supra.*

Gillis v. *United States,* 402 F.2d 501 (5th Cir. 1968); *The Washington Post Co.* v. *United States,* 186 Ct. Cl. 528, 405 F.2d 1279 (1969), and a number of other authorities, relied upon by plaintiff in support of the argument that his liabilities for "protested" state tax deficiencies, and interest thereon, were neither contingent nor contested, simply miss the mark. Without any quarrel with plaintiff's argument that it is the certainty of liability, and not the timing of payment, that is crucial to accruability, it suffices to answer, as defendant does, that a substantial protest directed toward reduction or deferral of an asserted liability for a given year amounts to a contest of some or all of that liability for that year, and thereby destroys the asserted certainty of liability upon which plaintiff relies. *United States* v. *Texas Mexican Ry. Co.,* 263 F.2d 31, 34 (5th Cir. 1959); *Helvering* v. *Russian Finance & Constr. Corp.,* 77 F.2d 324, 327 (2d Cir. 1935); *cf. Lutz* v. *Commissioner, supra; Woodmont Terrace, Inc.* v. *United States, supra.*

(B) *The Submissions to the Service*

The final issues to be resolved center upon plaintiff's written submissions to the Service, in 1970 and 1971, with respect to certain federal income tax deficiencies proposed in the revenue agent's March 9, 1970 report, and their effect upon plaintiff's claim of right to deduct, in the years 1962 and 1963, interest on such deficiencies.

1. As a result of circumstances under which the Service had obtained from plaintiff consents extending the statutory period of limitation, plaintiff took the position in July 1970 (and thereafter) that the statute of limitations on the

assessment and collection of proposed federal tax deficiencies for the years 1960 and 1961 had expired. Defendant contends that plaintiff's liability for such deficiencies, and for interest on such deficiencies in the years 1962 and 1963, was thus contested, and that plaintiff therefore may not properly accrue and deduct interest on such deficiencies in the years (1962 and 1963) to which such liabilities would otherwise relate.

Every asserted liability is subject to the possibility that the statute of limitations may ultimately run against its collection. The mere "possibility that a present liability may subsequently be discharged by some condition subsequent does not prevent its accrual on the taxpayer's books. * * * When books are kept on an accrual basis, a presently existing obligation which, in the normal course of events, the taxpayer is justified in believing he must fulfill, may be accrued. The existence of an absolute liability is necessary; absolute certainty that it will be discharged by payment is not." *Helvering* v. *Russian Finance & Constr. Corp., supra,* 77 F.2d at 327. Defendant's contrary argument is clearly untenable.

2. Defendant's moving brief contended that plaintiff contested the Service's failure to allow depreciation on an annealing furnace for 1962, and that "the applicable interest which related to 1963" was thus contested and not deductible in that year. While the Service's denial of a deduction for such depreciation for 1962 was admittedly contested, no part of plaintiff's claim herein involves interest on federal income tax deficiencies resulting from the Service's disallowance of a deduction for depreciation on the annealing furnace in 1962.

3. Finally, defendant says that a statement by plaintiff to the Commission that under both federal as well as state law he was entitled to continue to use the cash method of accounting, and plaintiff's September 20, 1971 suggestion to the Service that it would be "reasonable and just" to make the change in accounting method effective January 1, 1963, demonstrate that plaintiff contested his liability for increased federal income taxes (and interest thereon) attributable to a change in accounting method until 1971, and that, in consequence, the accrual of a deduction in

1963 for interest on such increased federal income tax deficiencies for 1962 "must be deferred until liability was either conceded or paid." Neither of these arguments has any merit.

It is difficult to conceive how an argument, however strongly worded, to the Commission might properly be deemed a contest of a liability asserted by an entirely different taxing authority. At the very least, denial of "the validity or accuracy, or both, of an asserted liability *to the person who is asserting such liability* * * *" is essential to the concept of "contest". Treas. Reg. § 1.461–2(b)(2). A passing suggestion to a party wholly unconcerned with liability to another that such liability may not exist cannot properly be considered to have the effect urged by defendant.

Nor does plaintiff's request, late in 1971, that the Service exercise its discretion preclude the accrual in 1963 of interest on increased federal income tax deficiencies for 1962 resulting from a change in plaintiff's method of accounting. *Lutz* v. *Commissioner, supra; Woodmont Terrace, Inc.* v. *United States, supra;* Treas. Reg. §1.461–2(b)(2). There was no bona fide dispute concerning the Service's right to make the change in accounting method effective January 1, 1960, as originally proposed, but only a naked suggestion to the Service as to when the change might be made effective.[19] When the Service concluded that the effective date of the change would be January 1, 1962, it was not authorized to deny plaintiff the benefit of consequences flowing from that change in accordance with the accrual method simply because of his September 1971 request. *Ibid.* See also *Dravo Corp.* v. *United States, supra.*

VI

For the reasons and under the authorities, and to the extent, set forth hereinabove, plaintiff's motion for summary judgment should be granted in part and denied in part,

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[19] Parenthetically, plaintiff's request to the Service, and his position before the Commission, with respect to the effective date of the change in accounting method differ sharply and significantly, and justify, and require, the differing treatment accorded them.

Syllabus

defendant's opposition to plaintiff's motion for summary judgment on the ground that a material issue of fact exists should be overruled, and defendant's motion for partial summary judgment should be denied in part and granted in part. Judgment should be entered that plaintiff is entitled to recover, and the case should be referred to the trial division for further proceedings pursuant to Rule 131(c).

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566 F.2d 1151

ROYALL NATIONAL BANK OF PALESTINE, TEXAS v. THE UNITED STATES

[No. 30–76. Decided December 14, 1977]

ON THE PROOFS

Small Business Administration approved loan; loan guaranty agreement.—Plaintiff seeks to recover from the Small Business Administration the guaranteed 90% portion of an SBA-approved loan made by plaintiff to a now-bankrupt company, which portion SBA refused to purchase. Although the borrower was to repay the loan, together with interest, in consecutive monthly installments, from the beginning the payments were irregular and after the eighth installment was due and unpaid the borrower was continually in default. Plaintiff did not give SBA the contractually required 30-day written notice of the occurrence of the default until almost 7 months later, although SBA had actual knowledge about 3 months after default. It is *held* that since the condition precedent regarding notification was not fulfilled, no obligation arose under SBA's promise to purchase. Plaintiff is not entitled to recover and the petition is dismissed.

Contracts; formation of contract; express contract; condition precedent.

[1] A precedent condition in a contract must be performed or happen before a duty of immediate performance arises on the promise which the condition qualifies. Thus, where plaintiff-bank's right to demand purchase by SBA of the guaranteed portion of the SBA-approved loan was conditioned upon written notification to SBA within 30 days of the borrower's default in payment, no obligation arose under the promise to purchase absent timely written notification of the default.

United States ⚖53(8)

A. D. Henderson, attorney of record, for plaintiff. *Allen Weed* and *Shank, Irwin, Conant, Williamson & Grevelle,* of counsel.

Stephen G. Anderson, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, KUNZIG and BENNETT, *Judges.*

PER CURIAM: This case comes before the court on defendant's motion, filed September 14, 1977, requesting that the court adopt, as the basis for its judgment in this case, the recommended decision of Senior Trial Judge Mastin G. White, filed August 5, 1977, pursuant to Rule 134(h), plaintiff having failed to file a notice of intention to except or exception thereto and the time for so filing pursuant to the Rules of the Court having expired. Upon consideration thereof, without oral argument, since the court agrees with the said recommended decision as hereinafter set forth*, it hereby grants defendant's motion, filed September 14, 1977, and affirms and adopts the decision as the basis for its judgment in this case. Accordingly, it is concluded that plaintiff is not entitled to recover and the petition is dismissed.

OPINION OF TRIAL JUDGE

WHITE, *Senior Trial Judge:* This action by the plaintiff, Royall National Bank of Palestine, Texas, is based upon the refusal of the Small Business Administration ("SBA") to purchase the guaranteed portion of an SBA-approved loan. The loan was in the amount of $125,000 and was made by the plaintiff on June 14, 1972, with the approval of the SBA, to a now-bankrupt company known as Consolidated Data Systems, Inc. ("CDS"). At the time when the loan was made, CDS was engaged in the electronic data processing business at Palestine, Texas.

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* Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed August 5, 1977, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

The authorization from the SBA to the plaintiff for the making of the loan to CDS stated that the SBA would guarantee 90 percent of the loan.

Some 3 years before the plaintiff made the SBA-approved loan to CDS, the plaintiff and the SBA entered into a blanket loan guaranty agreement. This was a standard form of contract which SBA entered into with numerous banks throughout the country. In substance, the agreement outlined the circumstances under which the SBA would share the risk of default on SBA-approved loans made by the lending bank.

Of particular interest in the present case is paragraph 7 of the blanket loan guaranty agreement between the plaintiff and the SBA, providing in part as follows:

> 7. Notice of Borrower's Default and Demand for Purchase. Lender shall have the right to make demand in writing for the purchase by SBA of its guaranteed percentage of any loan guaranteed hereunder, provided that such loan is in default * * * and such default has continued for not less than 60 days. * * * Default means nonpayment of principal or interest on the due date * * *. Lender shall notify SBA in writing within 30 days of any such default in payment * * *, and such notification to SBA shall be a condition precedent to the Lender's right to demand purchase by SBA.

CDS was to repay the $125,000 loan, together with interest, in consecutive monthly installments on the 14th day of each month, beginning August 14, 1972. From the beginning, however, CDS was irregular in making the prescribed monthly payments. For example, the August 1972 payment was made on August 25 rather than August 14; the December 1972 payment was not made until January 8, 1973; the January 1973 payment was made on January 29 rather than January 14; the February 1973 payment was not made until March 23; and the March 1973 payment was not made until April 18. The April 1973 payment was never made; and, indeed, CDS did not make any further payment on the indebtedness after making the March payment more than a month late, on April 18, 1973. At that time, more than $100,000 of the principal indebtedness remained unpaid.

It appears, from the recital in the preceding paragraph, that CDS was actually in default at all times after December 14, 1972, when the December installment on the indebtedness became due and was not paid until January 8, 1973, and CDS was also late thereafter in paying the January, February, and March installments. In any event, there can be no question about CDS being continually in default after April 14, 1973, when the April installment became due and was never paid, and CDS did not make any payments for subsequent months as they became due.

Notwithstanding the default by CDS, the plaintiff did not give the SBA written notice of such default until November 1, 1973.

The SBA did have actual knowledge of CDS's default prior to the receipt of the written notice from the plaintiff. The actual knowledge was not acquired, however, until July 13, 1973, when an SBA official called the plaintiff's president on the telephone, stated that he had heard from another source a rumor that CDS was contemplating bankruptcy proceedings, and inquired about the status of the $125,000 loan to CDS. The plaintiff's president then informed the SBA official that CDS was in default on the monthly payments. This was the first information received by the SBA concerning CDS's default. Thus, the SBA was unaware of CDS's default until approximately 3 months had elapsed after CDS stopped making payments on the loan—and CDS's final payment was more than a month overdue when made.

The financial condition of CDS seriously deteriorated between the company's default on the $125,000 loan and the date when the SBA received actual knowledge of the default. Even through May 1973, one branch of CDS was showing a profit; and the company was not forced to stop operations until later, in June 1973. By mid-July of 1973, however, CDS's assets were worth only $8,500, and the company had a negative net worth of $80,000.

On November 9, 1973, CDS commenced bankruptcy proceedings in the United States District Court for the Eastern District of Texas; and the company was adjudicated a bankrupt 4 days later. The plaintiff did not

receive any proceeds from the referee in bankruptcy as a result of those proceedings.

The evidence in the record, as summarized briefly up to this point, plainly shows that CDS defaulted on the $125,000 SBA-approved loan and remained in default continually after April 14, 1973, at the latest; that the plaintiff, as the lender, did not notify the SBA in writing (or otherwise) within 30 days of such default; and that the SBA was unaware of the default until long after the expiration of the 30-day period immediately following the default.

The defendant relies upon the portion of paragraph 7 of the blanket loan guaranty agreement between the SBA and the plaintiff which declares in plain language that "such notification to SBA [in writing within 30 days] shall be a condition precedent to the Lender's right to demand purchase by SBA" of the guaranteed portion of an SBA-approved loan. The defendant argues that as the plaintiff failed to give the required notice of default, which was a condition precedent to the creation of any obligation on the part of the SBA to purchase the guaranteed portion of the $125,000 loan to CDS, the present action must necessarily fail, without regard to other factors.

The defendant's position is supported by 5 WILLISTON, CONTRACTS, § 666A (3d ed. 1961), which states in part that "A precedent condition in a contract * * * must be performed or happen before a duty of immediate performance arises on the promise which the condition qualifies."

The plaintiff's response to the defense previously outlined is to contend (incorrectly) that CDS was not in default until May 14, 1973, and to contend further (also incorrectly) that the plaintiff informed the SBA of such default on June 13, 1973, or within the prescribed 30-day period. As previously stated in this opinion, CDS's default occurred on April 14, 1973, at the latest, and the plaintiff's first notification to the SBA of such default was given on July 13, 1973, in response to an inquiry from the SBA, and the notification was oral in nature.

As the SBA's promise to purchase the guaranteed portion of the loan to CDS in the event of a default was conditioned upon receiving from the plaintiff a written

notice of such default within 30 days of its occurrence, and as the condition precedent was not fulfilled, no obligation arose under the SBA's promise.

The conclusion just stated makes it unnecessary to consider the defendant's alternative defense to the effect that the plaintiff breached the contract between the SBA and the plaintiff in various material respects, thereby excusing the defendant from discharging its guaranty obligation in any event.

It necessarily follows that the plaintiff is not entitled to recover, and that the petition should be dismissed.

CONCLUSION OF LAW

Upon the trial judge's findings and opinion, which are adopted by the court, the court concludes as a matter of law that the plaintiff is not entitled to recover, and the petition is therefore dismissed.

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568 F.2d 1316

GEORGIA-PACIFIC CORPORATION v. THE UNITED STATES

[No 315–75. Decided January 25, 1978]*

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

Eminent domain; concurrent pendency of taking and condemnation actions; appropriate forum for determining taking date and valuation; suspension of proceedings.—In August 1975 plaintiff (G-P) filed the present inverse condemnation action seeking just compensation for an alleged taking prior to August 1975 by the United States of certain of its lands in West Virginia. On March 5, 1976 the United States filed a condemnation action and declaration of taking in the Southern District of West Virginia respecting said land for a dam and flood control project, but assuming that the taking occurred on March 5, 1976. The district court denied G-P's request to stay valuation proceedings until resolution of the present suit; the Fourth Circuit dismissed G-P's appeal, holding the district court's order nonappealable and that the district court did not abuse its discretion in denying the

* On April 24, 1978 plaintiff filed a petition for writ of certiorari.

Syllabus

request. G-P alleges here that the Corps of Engineers beginning in 1972 in connection with the project instituted severe restrictions on G-P's mining use in the area, and that these restrictions, certain threatened legal actions and informal prohibitions and regulations, together with a refusal or inability to condemn the property outright, constituted an inverse taking. Defendant argues it was merely exercising its rights under agreements with G-P and/or imposing lawful regulations which fall short of a taking. No physical invasion of the property by the Government has occurred. It is *held* that the district court has the authority in the condemnation suit to determine whether the date of taking was March 5, 1976 or prior to August 1975 and to value the property as of the date of taking it finds. Since standards of efficiency, expedition and inexpensiveness call for the centralization, in the present situation, of the whole proceeding in one tribunal rather than the bifurcation insisted upon by each party, the court suspends further proceedings to allow the district court opportunity to decide whether it will consider any alleged taking date prior to March 5, 1976.

Pleading and practice; summary judgment; when appropriate.

[1] Where the court is presented, on motions for summary judgment, with disputed issues of material fact and where, to the extent that portions of the issues which might be found to be "legal" are so complex and intermeshed with factual and particular details, summary judgment is inappropriate.

Federal Courts ⚖1120

Eminent domain; taking; date of taking.

[2] Where a declaration of taking is filed after the Government has taken possession, the date of taking is the prior date on which the Government entered and appropriated the property to public use. Such entry is the time of taking for purposes of valuing the property and fixing the date on which the Government's obligation to pay interest begins to run.

Eminent Domain ⚖124

Pleading and practice; stay or suspension of proceedings; concurrent pendency of taking and condemnation actions; date of taking determination; forum.

[3] Where the landowner's suit in the Court of Claims for a Government taking of its property preceded the Government's filing of a condemnation suit in a district court, where the legally significant issue is the date of taking, and where neither relevant statutes nor the concept of a condemnation suit preclude the condemnation court from determining whether the property has been compensably taken by the Government and if so when, the value of the property as of that date of taking, and passage of title to the Government through ascertainment and payment of compensation, it is appropriate for the Court of Claims to suspend further proceedings in the litigation before it until the condemnation court decides the questions or has refused to inquire whether a date prior to the filing of the condemnation action is the correct one. It is ordinarily better to centralize the proceedings in the tribunal which has

the widest scope to handle all parts of what is in commonsense one unified piece of litigation.

Action ⚖69(5)

Eminent domain; taking; date of taking; determination of in declaration-of-taking action.

[4] The theory of *United States* v. *Dow*, 357 U.S. 17 (1958), that where the Government enters into possession of property prior to the filing of a declaration of taking, it is the former event which constitutes the act of taking and gives rise to the claim of compensation, is not limited in its application to a situation where the Government itself puts forth an earlier taking date than the filing of the declaration of taking; the landowner is not precluded from contending that the actual taking preceded the taking-declaration.

Eminent Domain ⚖124

Angelo A. Iadarola, attorney of record, for plaintiff. *Wilkinson, Cragun & Barker, Philip A. Nacke* and *Charles I. Appler,* of counsel.

L. Mark Wine, with whom was *Assistant Attorney General James W. Moorman,* for defendant. *Eric S. Gould,* of counsel.

Before DURFEE, *Senior Judge,** DAVIS and KASHIWA, *Judges.*

DAVIS, *Judge,* delivered the opinion of the court:

This troubling problem is what should be done when a claimant brings suit in this court for an inverse condemnation of land interests, and not long thereafter the Government files a District Court condemnation action involving the very same interests but asserting a later taking-date. On August 22, 1975, Georgia-Pacific filed its petition here asking just compensation for an alleged taking by the Federal Government in 1974–1975 of certain of its land in West Virginia. About half-a-year later, on March 5, 1976, the United States filed a condemnation action and declaration of taking in the Southern District of West Virginia (*United States v. 9,268.52 Acres of Land,* Civil No. 76–0045BL), covering all the land embraced in plaintiff's petition in this court but assuming that the taking occurred only on March 5, 1976.

* Senior Judge Durfee died after the argument but before the preparation and adoption of this opinion.

Georgia-Pacific asked the District Court for a stay of the valuation proceedings in the condemnation suit until resolution of its claim in this court for a prior taking. The District Court denied this motion and the Fourth Circuit dismissed the company's appeal, holding the District Court's order non-appealable and also that there was no such abuse of discretion as to necessitate resort to the extraordinary remedy of mandamus. *United States of America v. Georgia-Pacific Corp.*, 562 F.2d 294 (1977). Meanwhile both parties had moved for summary judgment in this court, overwhelming us with long and detailed briefs, and a mass of affidavits and documents. Defendant urges, of course, that no eminent domain ensued upon the Government's activities in 1972–1976 until the institution of the West Virginia condemnation action in March 1976. Plaintiff sought to prove, on the contrary, that a taking had occurred before the beginning of the current suit in August 1975.[1]

If we felt compelled to determine the merits of the parties' respective positions, we clearly would not do so on these cross-motions for summary judgment. There is a hard residue of factual dispute which would first have to be tried and determined in the Trial Division. And to the extent

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[1] In 1962 Congress first authorized the R.D. Bailey Lake Project (in West Virginia) primarily for flood control. After considerable study and reevaluation, the Project evolved into one encompassing approximately 20,000 acres in the coal-producing region of West Virginia. Georgia-Pacific was the largest land-owner, controlling some 7,000 acres in fee and having subsurface rights to another 2,500 acres. The company claims that at first the Corps of Engineers (which was responsible for the Project) allowed mining operators to continue their work so long as they did not interfere with the Project but that, beginning in 1972, the Corps, pushed by environmental interests represented on Congressional Committees, developed and ultimately put into effect severe restrictions on mining use in the area. These alleged restrictions, plus a series of threatened legal actions and asserted informal prohibitions and regulations, together with a refusal or inability to condemn the property outright—all alleged to have led to the limitation, postponement or abandonment of mining activity by plaintiff's coal lessees—are said by plaintiff to have constituted the inverse taking for which it sues in this court. Plaintiff says that thereby it "suffered a taking by defendant, without compensation, of its sub-surface mineral holdings totalling 9,288.07 acres, and so much of the surface as was necessary for development of the sub-surface within the designated Project boundaries." There was at no time any physical invasion of the property by the Government. The defense here is that the Government was merely exercising its rights under agreements it had with Georgia-Pacific and/or imposing lawful regulations which fell short of a taking.

that there are portions of the contested issues which might in the end be found to be "legal," they are so complex and so intermeshed with factual and particular details that we would first ask a trial judge to sift through the mass of material thrust upon us.[2] *See Cheyenne-Arapaho Tribes v. United States*, 206 Ct. Cl. 340, 349, 512 F.2d 1390, 1394 (1975); *Space Research Corp. v. United States*, *post* at 941. This is another case in which summary judgment will not serve as a short-cut or a by-pass. *See Julius Goldman's Egg City v. United States*, 214 Ct. Cl. 345, 556 F.2d 1096 (1977).

We have decided, however, that there is another course we can properly take and should follow. In our view, which we shall spell out, the District Court has the authority, in the condemnation suit, first, to determine whether the date of taking was March 5, 1976 (when that action was begun by the United States and the declaration of taking filed) or the pre-August-1975 date claimed by Georgia-Pacific in the present inverse condemnation case, and second, to value the property as of the date of taking it finds.[3] Accordingly, we shall suspend further proceedings in this litigation until the District Court has decided when the date of taking occurred, or has refused to inquire whether a time prior to March 5, 1976, is the correct one.

The legally significant bone of contention is the date of taking. Georgia-Pacific tells us that coal-land prices were higher in 1974–1975 and relatively low in March 1976 when the declaration of taking was filed; it is even hinted that the Government may have deliberately waited for such a favorable time before beginning its condemnation action in the District Court. That is why the company pushes its claim here.[4] But the District Court, in our opinion, is not bound to adopt the March 1976 date as the

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[2] Plaintiff's briefs on the cross-motions run to 325 pages and its affidavits and documents add three additional volumes. Defendant's briefs came to 105 pages plus two and one-half volumes of affidavits and documents.

[3] Both parties summarily rejected this position when it was tentatively broached from the bench during oral argument. Nevertheless, after reflection, we consider it the most appropriate disposition.

[4] Plaintiff also notes that it would be able to obtain greater interest if the taking-date were in 1974–75, and that if the suit continued here Georgia-Pacific would be eligible (if it prevailed) for an award of attorneys' fees under 42 U.S.C. § 4654(c).

taking date for Georgia-Pacific's lands; if it accepts the present claimant's position it can find that the lands were taken on some date in 1974 or 1975, and then the court can value the property as of that time.

We draw this conclusion largely from *United States v. Dow*, 357 U.S. 17 (1958), in which the Supreme Court ruled in a condemnation suit that the claim to just compensation for the taking of an easement vested in the landowners at the time the Government entered into possession of the easement (1943) rather than the later date when the declaration of taking was filed (1946). In 1943 the United States brought a condemnation proceeding to acquire a certain right-of-way for a pipeline; no declaration of taking was filed at that time but the Government entered into immediate possession under a court order. Thereafter (in 1945) the tract (subject to the right-of-way) was conveyed to Dow and in 1946 the Government filed a declaration of taking covering the right-of-way, depositing estimated compensation.

The issue before the Court was whether Dow—who had no interest when the United States entered into possession in 1943 but did have an interest at the time of the declaration of taking in 1946—was entitled to any award for the right-of-way. The Court held not. It declared that Dow could prevail only if the "taking" occurred while he was the owner (357 U.S. at 20–21), but that the "taking" occurred in 1943 when the Government entered into possession of the right-of-way (357 U.S. at 21). If the United States enters in possession before the formal acquisition of title (which passes on payment), the normal rule is that "it is the former event which constitutes the act of taking. It is that event which gives rise to the claim for compensation and fixes the date as of which the land is to be valued and the Government's obligation to pay interest accrues" (357 U.S. at 22). Similarly, where a declaration of taking is filed after the Government has taken possession, the date of "taking" is the prior date on which the Government entered and appropriated the property to public use (357 U.S. at 23). That rule is consistent with the principle that such entry is the time of taking for purposes of valuing the property and fixing the date on which the Government's

obligation to pay interest begins to run (357 U.S. at 24); the rule also works against manipulation by owners or the Government which might occur if a later declaration of taking were thought to be the taking (357 U.S. at 25).

The theory of *Dow*, with its insistence on the date of actual taking as the valuation date and the date from which interest begins to run, seems to us to empower the condemnation court, in a case like this, to find that the actual taking (like the Government's entry onto the right-of-way in *Dow*) preceded the declaration of taking. The one obvious difference from *Dow* is that there the condemnation suit had been brought before the entry was effected while here the taking claimed by Georgia-Pacific (if there was one) antedated the beginning of the condemnation suit (which was contemporaneous with the declaration of taking). Under the *Dow* rationale that distinction seems to us irrelevant to the authority of the condemnation court to determine the date of actual taking. Neither the terms of the legislation granting the Government the right to bring the condemnation action (33 U.S.C. §§ 591, 701c–1, *see also* 40 U.S.C. § 257), nor the conception of a condemnation suit, preclude the condemnation court from deciding that the actual date of taking preceded the filing of the suit. A condemnation suit is one means of determining that the Government has title to property or of passing title to the Government. The objective of such a suit is not restricted to effectuating a transfer of actual possession from the asserted landowner to the United States (though that is a sufficient aim, *United States v. 93.970 Acres of Land*, 360 U.S. 328, 330, 332 (1959); *Best v. Humboldt Mining Co.*, 371 U.S. 334, 340 (1963)). Other significant purposes (which can be pursued even where the Government already has possession) are to pass title to the Government (as *Dow* held, title, distinguished from possession, does not pass until compensation is paid or made available to the owner) or to make it clear, in case of dispute, that the Government already has full right to use or possess the property without payment of further compensation. *See United States v. 93.970 Acres of Land, supra*, 360 U.S. at 330, 332; *Best v. Humboldt Mining Co., supra*, 371 U.S. at 335, 340; *United States v. 422,978 Square*

Ft. of Land, San Francisco, 445 F.2d 1180, 1188–89 (9th Cir. 1971).[5] Even the function of valuation need not necessarily be performed by the condemnation court; the Supreme Court has held a condemnation suit sufficiently malleable and all-encompassing, where the Government's right to property is involved, to allow the court to delegate determination of a mining claim to administrative proceedings. *Best v. Humboldt Mining Co., supra.* We consider, then, that the current theory of the condemnation suit allows the condemnation court great leeway, and that, where the Government sees fit to bring a condemnation suit, the court is authorized to make an authoritative determination, first, whether or not the property was compensably taken by the United States at all and if so when, second, of the value of that property as of that date of taking, and, third, of the passage of title to the Government through the ascertainment and payment of compensation.[6]

To us, the standards of efficiency, expedition, and inexpensiveness (*cf. United States v. 93.970 Acres of Land, supra*, 360 U.S. at 332) call for the centralization, in the present situation, of the whole proceeding in one tribunal rather than the bifurcation insisted upon by each party (*see* note 3, *supra*). The condemnation proceeding covers several parties in addition to Georgia-Pacific. We thus have only part of the eminent domain litigation in this court. If we were to decide the merits of the pre-March 1976 taking issue proffered by Georgia-Pacific, the District Court would either have to delay its entire proceeding until we had concluded ours, or go ahead with respect to other parties (at the risk of repetitive further litigation if it was ultimately decided here that Georgia-Pacific was wrong in

[5] The *422,978 Square Ft. of Land* opinion said: "Filing the complaint in condemnation did not alone constitute a taking [citing cases] but was only a method of adjudicating the contention of the United States that the State [of California, the asserted landowner] was not entitled to compensation."

[6] In *United States v. 422,978 Square Ft. of Land, San Francisco, supra*, 445 F.2d at 1182–84, 1187–1189, the Ninth Circuit decided, in a condemnation suit first brought in 1955, that the taking, if any, occurred in 1940 and the landowner (the State of California) was barred from all recovery in the condemnation suit because it failed to seek Tucker Act relief within six years (the limitations period) after 1940. Thus, the court held in a condemnation action begun in 1955, that any taking occurred no later than 1946.

its claim of a pre-March 1976 taking) or proceed with its whole case (at the risk of contemporaneous litigation in both tribunals, litigation which might prove wasteful and unnecessary in the District Court if Georgia-Pacific prevailed here on its claim). And even if the District Court (despite its previous denial of Georgia-Pacific's stay motion) chose to wait for our proceedings, the matter would still have to go back there if we decided that no taking occurred before March 5, 1976; we have no jurisdiction to determine valuation if the taking occurred only when the taking-declaration was filed on that date. The nub of it is that only the District Court is in a position to decide all phases of the litigation in the event Georgia-Pacific's claim of an early taking should be rejected.

Moreover, a single tribunal is better able than two or more independent courts to direct and handle variant and alternative claims all bearing on the same situation. Sometimes such unified treatment is precluded by jurisdictional statutes, but where it is not—as we think is true of this instance—it is ordinarily better to centralize the proceedings in the tribunal which has the widest scope to handle all the parts of what is in commonsense one unified piece of litigation. That is a strong thread running throughout the law from the theory of the compulsory counterclaim to the creation of the Judicial Panel on Multidistrict Litigation.

To these demands of practicality there have been opposed some technical arguments which we consider unavailing. The Government has told us that the *Dow* theory can only be used where the Government itself puts forth (as it did in *Dow*) an earlier taking-date than the filing of the declaration of taking. We know of no reason why this should be so; nothing in the *Dow* opinion or the current theory of condemnation suits (as we understand it, *see supra*) gives the Government such a one-sided choice or precludes the landowner from saying that the actual taking (stressed in *Dow*) preceded the taking-declaration. On the other hand, Georgia-Pacific told the District Court[7]

[7] In its Memorandum of Points and Authorities In Support of Defendant Georgia-Pacific Corp.'s Motion for Stay of Proceedings.

that that tribunal had no authority to consider a pre-March 1976 taking date because to take that course would be tantamount to entertaining a forbidden counterclaim by Georgia-Pacific against the United States under the Tucker Act for more than $10,000: But that position would be valid only if the District Court, in its role as a condemnation court, were forbidden from considering any date of taking before March 5, 1976, and accordingly were able to consider Georgia-Pacific's pre-March 1976 position only in its capacity as a Tucker Act court determining a monetary claim against the United States. We have shown above that the postulate is incorrect—that the District Court, as a condemnation court, can decide whether or not the taking occurred in 1974 or 1975. In the District Court there is no affirmative claim at all by Georgia-Pacific against the Government and the Tucker Act is not implicated. The condemnation action puts in issue the date of taking if Georgia-Pacific so wills it; if Georgia-Pacific tells the condemnation court, as we think it should, that in the company's view the taking occurred before March 5, 1976, that court can (in our view) decide the question and determine compensation accordingly—all in its capacity as the condemnation court.[8]

We do not say that this court is without jurisdiction over the claim of a taking before March 1976. Our position is that both this court and the District Court can take account of, and decide, that claim—but that only the District Court, now that the Government has filed a

[8] Neither *United States v. Certain Land*, 203 F.Supp. 454 (S.D.N.Y. 1958), nor *Meyer v. United States*, 138 Ct. Cl. 86, 150 F. Supp. 314 (1957), 141 Ct. Cl. 537, 159 F. Supp. 333 (1958), decides anything to the contrary. In *Certain Land* the Government's condemnation complaint itself admitted on its face, and the landowner agreed, that the United States had been in possession of the property, before the condemnation suit was commenced, as a holdover tenant under a specified lease from the defendant landowner—the condemnation suit purported to cover that prior period as well as future occupancy—and the court held that in those circumstances determination of the rental value for the prior period would necessarily amount to a Tucker Act suit for holdover rent which was for more than $10,000 and beyond the District Court's jurisdiction. *Meyer* involved the Government's defense that a lessor's complaint here was barred by 28 U.S.C. § 1500 where the Government had filed a condemnation suit purporting to cover, retroactively, the same leasehold interest; the court held that § 1500 bars only duplicative suits by claimants, and does not cover the situation where the other suit is brought by the Government itself.

condemnation suit, has authority to determine all aspects of Georgia-Pacific's right to compensation,[9] and therefore that the District Court is the preferred forum in which to center the whole litigation.

These are our views, but the District Court (or higher tribunals) may disagree either as to the range of the condemnation court's authority or as to the discretionary appropriateness of converging all aspects of this particular litigation in the District Court. We shall therefore do no more than suspend proceedings here until the District Court has had the opportunity to determine what course it will take. If that court (or a higher court) rules that it will not consider any date of taking before March 1976, we shall terminate the suspension here and proceed toward determination of the inverse condemnation claim of a pre-March 1976 taking. We have already indicated, *supra*, that in that event we shall need the help of the Trial Division in the face of the detailed issues and the overwhelming accumulation of affidavits, documentation, and argumentation presented to us.

Proceedings here are suspended to allow the District Court opportunity to decide whether it will consider any alleged taking date prior to March 5, 1976.

So ordered

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568 F.2d 1322

DeMAURO CONSTRUCTION CORPORATION v. THE UNITED STATES

[No. 359–75. Decided January 25, 1978]

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

Court of Claims jurisdiction; Ryukyu Islands administration; treaty with Japan; dam construction; changed condition; breach of contract; proper parties.—From 1945 until May 1972 the United States exercised exclusive jurisdiction over the Ryukyu Islands under

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[9] *I.e.*, only the District Court can determine valuation if the taking date is held to be March 5, 1976.

Syllabus

the peace treaty with Japan. In 1957 Executive Order No. 10713 established a dual system of government for the Islands, considerable control being returned to local institutions and Japan's residual sovereignty being acknowledged. The principal objective of the Order was to promote the economic and cultural welfare and advancement of the Islands' inhabitants; an implementing ordinance entitled "Establishment of the Ryukyu Domestic Water Corporation" (RDWC) was enacted to alleviate water shortages. To further this plan, in 1963 a Memorandum of Understanding was signed by RDWC and the U.S. Corps of Engineers, the Chief of Engineers for the U.S. Army being designated as agent for RDWC for implementation of the various water projects, including procurements. Following an advertised invitation for bids, plaintiff in June 1964 entered into a lump-sum contract signed only by plaintiff and a representative of the Corps of Engineers for construction of an earth-filled dam in Okinawa. There is no reference to the existence of other parties to the contract. In constructing the dam, plaintiff found that the contemplated fill was inadequate and sought additional compensation claiming a changed condition, the contracting officer denied the claim, and on appeal the ASBCA found that plaintiff was entitled to an equitable adjustment. The question of the amount due plaintiff was to be negotiated by the parties or, if they failed to agree, the Government was directed to make a unilateral determination from which plaintiff could take a further appeal if dissatisfied. The Government refused to negotiate, contending that under the 1972 treaty with Japan the latter assumed all obligations relating to construction of the dam, that the United States was no longer authorized to represent RDWC, and that the real party in interest was RDWC. Plaintiff is now seeking damages for breach of contract. Defendant contends that the court lacks jurisdiction to decide this case because the United States was never a true party to the agreement but rather was acting as an agent for RDWC; defendant also asserts that it was released by a contract modification and that appropriated funds were not authorized for the dam construction. Plaintiff contends that the RDWC was an instrumentality of the United States and that defendant is liable whether or not it acted as an agent of the RDWC. It is *held* (1) that the United States itself was a party to the contract and was obligated thereunder, that at all times in controversy the United States exercised full jurisdiction over the Islands, and that the court need not reach the question of whether a contract binding the RDWC would also bind the United States; (2) that the modification did not affect the substantive rights of the parties; (3) that U.S. funds had been appropriated directly for the dam; (4) that since the rights on which plaintiff is suing accrued prior to the 1972 treaty, the latter did not extinguish those rights; (5) that plaintiff is entitled to an equitable adjustment for the changed condition; and (6) that this action for breach of contract is properly maintainable in this court. Defendant's motion for summary judgment is denied, plaintiff's crossmotion is granted, and

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the case is remanded to the trial division for further proceedings under Rule 131(c) to determine the amount of recovery due plaintiff.

Contracts; parties; who are parties.

[1] Generally, where parties have executed a self-contained and, on its face, an integrated document, the burden of changing the expressed obligations is heavy. Where: the subject contract was signed only by the contractor and a representative of the United States agency which invited bids, the contract does not state that the parties are other than those signatory thereto, and the Ryukyu Islands-based agency was created as an instrumentality of the United States Civil Administration of the Islands (the sole administrator) to facilitate administration of the Islands, absent persuasive evidence changing the expressed contractual obligations, the United States must be considered a party to the contract and obligated thereunder, and not the Islands-based agency on whose behalf the United States contends it executed the contract. The signature of the United States on the contract, together with the exclusivity of American control of the Islands demonstrates that the United States at the time the contract was signed intended to be bound thereby.

United States ⚖63

Contracts; interpretation; novation, what constitutes.

[2] A contract modification for purposes of substituting a party to be charged for supplies and services obtained under the contract but specifically providing that the change was for administrative purposes only and was not intended to affect the substantive rights of either signatory to the contract, cannot be considered sufficient notice to the contractor of a possible novation releasing the Government of its obligations under the contract.

United States ⚖72(5)
Novation ⚖1

Court of Claims jurisdiction; contracts; Ryukyu Islands dam project.

[3] The consent of the Federal Government to be sued as provided in the Tucker Act does not normally embrace suits on contracts of congressionally created territorial sovereigns, even though they are beyond question instrumentalities of the United States. Where appropriated funds were used to carry out an authorized dam project for purposes directly related to United States national defense in the Ryukyu Islands over which the United States was the sole administrator, such funds are not insulated from liability for contracts executed by United States officials acting on behalf of an Islands-based agency created to alleviate water shortages. The fact that the agency was expected eventually to reimburse the United States does not vitiate this court's jurisdiction over a contract claim against the United States for additional compensation by reason of a changed condition.

Federal Courts ⚖1076
United States ⚖125(16)

Treaties; retroactive operation.

[4] A treaty does not relate back to extinguish private rights vested prior to the effective date of the treaty, and absent an express intent by

Opinion of the Court

Congress to cut off rights, the court retains jurisdiction of a cause of action arising prior to the treaty.

Treaties ⚖10

Contracts; breach; refusal of defendant to negotiate as directed by Board.

[5] Where defendant has refused to negotiate an equitable adjustment on the contractor's claim of a changed condition as directed by the Board of Contract Appeals, an action for breach of contract is properly maintainable in the Court of Claims.

United States ⚖74(7)

John H. Tracy, attorney of record for plaintiff. *Lewis, Mitchell & Moore,* of counsel.

Frances L. Nunn, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before LARAMORE, *Senior Judge,* NICHOLS and KASHIWA, *Judges.*

NICHOLS, *Judge,* delivered the opinion of the court:

This case, which concerns the construction of the Tengan Dam in Okinawa, is before the court on cross-motions for summary judgment. Defendant contends that the court lacks jurisdiction because the suit properly should be brought by DeMauro against the government of Japan, not the government of the United States. Plaintiff argues, conversely, that it contracted with the United States. We agree with plaintiff and find that the involved contract has been breached.

To clarify the positions of the parties, we are including some background information regarding the American occupation of the Ryukyus.

From the military conquest during World War II in 1945, until May of 1972, the United States exercised full control over the Ryukyu Islands, of which Okinawa is the largest. Following their surrender, these islands were treated as separate and distinct territory for the purpose of occupation, rather than as an integral part of Japan. Unlike other occupied territories, which were administered jointly by the Allied Powers, the occupation of the Ryukyus continued under exclusive American jurisdiction under powers derived from the peace treaty with Japan, when made.

After an initial period of military government, however, considerable control was returned to local institutions, and Japan's residual sovereignty was acknowledged. Executive Order No. 10713, 22 F.R. 4007, U.S. CODE CONG. & AD. NEWS 903 (1957), established a dual system of government in the Ryukyus for the duration of American occupation. The local administration consisted of the Central Government of the Ryukyu Islands, with a one-house legislature of 29 representatives elected directly by the Ryukyuans. The Order also provided a Civil Administration under the Department of Defense. The Secretary of Defense was to appoint a High Commissioner, a member of the military, under whom was organized the so-called United States Civil Administration of the Ryukyu Islands (USCAR) to aid in governing the Islands. A measure of coordination between the two administrations was accomplished by the High Commissioner's appointment, after consultation with the legislature, of a Ryukyuan Chief Executive. *See generally, Rose* v. *McNamara,* 375 F.2d 924, 926–27 (D.C. Cir.), *cert. denied,* 389 U.S. 856 (1967); *Burna* v. *United States,* 240 F.2d 720, 721 (4th Cir. 1957); *Cobb* v. *United States,* 191 F.2d 604, 608 (9th Cir. 1951), *cert. denied,* 342 U.S. 913 (1952); S. REP. No. 674, 90th Cong., 1st Sess. (1967); S. REP. No. 1738, 86th Cong., 2d Sess. (1960). *See also,* Executive Order No. 11010, 27 F.R. 2621, U.S. CODE CONG. & AD. NEWS 4326 (1962), which updated Executive Order No. 10713.

According to Executive Order 10713, one of the principal objectives of the occupation government was to promote the economic and cultural welfare and advancement of the Ryukyu inhabitants. To facilitate this directive in part, USCAR issued HI COM ORDINANCE NUMBER 8, on September 4, 1958. This ordinance was entitled "Establishment of the Ryukyu Domestic Water Corporation." Appended to the ordinance was a charter for the Ryukyu Domestic Water Corporation (RDWC), stating that the RDWC was created as "an instrumentality of the United States Civil Administration of the Ryukyu Islands." The purpose of the RDWC was to take action to alleviate water shortages on the islands. As early as 1957, USCAR recognized the need for constructing a water system to remedy the shortage of

domestic drinking water. In 1963 a "Memorandum of Understanding Concerning the Construction Incident to the Strengthening and Expansion of the Integrated Water System, Okinawa" was executed. The memorandum was signed by representatives of the RDWC and by the U.S. Corps of Engineers. Under the agreement, the Chief of Engineers for the United States Army is designated as agent for the RDWC for implementation of various water projects. The Memorandum also describes the tasks, essentially those of the procurement process, to be assigned to the Engineers.

The United States Army Corps of Engineers, issued an invitation for bids, No. 92–328–64–19. The advertisement solicited bids on the construction of the Tengan Dam and Reservoir and appurtenant work on Okinawa. On June 8, 1964, the contract was awarded to DeMauro in the lump-sum amount of $531,782. The contract, which was executed on June 26, 1964, was signed by the DeMauro Corporation, and for the United States, by Colonel H. C. Schrader of the Corps of Engineers. The document was not signed by any additional parties, nor does it anywhere refer to the existence of other parties to the contract.

This suit concerns a claim which arose, during the course of performance, out of a changed condition. The Tengan Dam was designed as an earthen dam running approximately north and south across a stream valley between points of high ground, with the upstream face to the west and the reservoir to the northwest. The central feature in the design of the actual dam was its core, which was to consist of a central structure of impervious fill. In constructing the dam, plaintiff discovered that less fill was available than had been indicated in the contract drawings. Accordingly, plaintiff sought additional compensation under the contract for a changed condition. After the claim was denied by the contracting officer, DeMauro appealed to the Armed Services Board of Contract Appeals. In a decision of November 7, 1972, the Board found that the government was liable for the changed condition, and ordered the parties to negotiate an equitable adjustment. ASBCA No. 12374, 72–2 BCA ¶ 9767. If the parties could not agree on an amount to be paid to the contractor, the

government was directed to make a unilateral determination, which could be appealed to the Board.

On December 22, 1972, plaintiff wrote to defendant requesting a preliminary meeting to establish negotiation procedures. Another letter, to the same effect, was sent on January 22, 1973. After several attempts were made by DeMauro to institute negotiations, the government eventually informed plaintiff that it would not negotiate because of the 1972 treaty under which the Islands reverted to Japan. Defendant contended that under the treaty the government of Japan assumed all the obligations relating to construction of the Tengan Dam, and, therefore, the United States was no longer authorized to represent the RDWC. The government also asserted at this time that the real party to the contract was, and always had been, the RDWC. DeMauro is now in this court seeking recovery for breach of this contract.

Defendant contends, for a number of reasons, that we do not have jurisdiction to decide this case. First, defendant asserts that it never was a true party to the agreement, but rather was acting as an agent for the RDWC, and, in this capacity, executed the contract on RDWC's behalf. Apparently, according to the government, the failure to note this fact when the contract was executed by Colonel Schrader was inadvertent. The government also contends that if it ever was obligated under the contract, it was released by a modification to the contract which was assented to by the plaintiff. Defendant further maintains that under the treaty with Japan, any obligations which might conceivably have been imputed to the United States were assumed by the government of Japan, and were thereafter the sole responsibility of the Japanese government. Finally, it is argued that the court has no jurisdiction over DeMauro's claim because no appropriated funds were ever authorized by Congress for construction of the Tengan Dam.

We are convinced that the United States was indeed a party to the contract with DeMauro. Again, the contract itself nowhere states that the parties are any other than those signing it, and the document is signed only by the DeMauro Company and by Colonel Schrader, an engineer

with the United States Corps of Engineers. The RDWC is mentioned nowhere. To the contrary, the contract is a standard federal procurement form, specifically identifying the government as the contracting party. Moreover, it was the Corps of Engineers, not the RDWC, which invited bids and awarded and administered the contract. These facts belie the government's contention that RDWC was the party which was bound rather than the United States. In general, where parties have executed a self-contained, and, on its face, integrated document, the burden of changing the expressed obligations is heavy. *See, e.g., Woodbury* v. *United States*, 176 Ct. Cl. 838, 850–51, 857–58, 364 F.2d 993 999–1000, 1003 (1966). No evidence has been offered which would lead us to believe that the government could meet such a burden.

The strongest documentary evidence which might be asserted to support the contention that the government acted solely as an agent for the RDWC, and did not intend to be bound itself is contained in the Memorandum of Understanding, discussed *supra*. Although this memorandum created a right on the Corps of Engineers' part to proceed as an agent of the RDWC, if they so wished, it can hardly be said to require that all contracts pertinent to constructing the water system be executed exclusively in this agency capacity. In the instant case, the government apparently chose not to do so.

It might also be noted that this issue does not seem to have come up in the litigation which was pursued in the Board of Contract Appeals. The Board, in its decision, clearly treated the United States as the contracting party. This strengthens our conclusion that in fact the United States was a party to the contract, and was obligated thereunder.

At this point, it is appropriate to note that defendant submits that a modification issued during the course of performance had the effect of clarifying the agency relationship between the United States and the RDWC. Modification 13 was issued on February 28, 1967, for the stated purpose of reflecting correct administrative and appropriation data. In essence, the modification substituted the RDWC as the party to be charged for supplies and

services obtained by the contract. The modification specifically indicates, however, that "[t]he * * * change is for administrative purposes only and is not intended to affect the substantive rights of either party."

The modification itself was never signed by a representative of the DeMauro Corp. There was, however, a cover letter accompanying the modification which was signed by the company. The cover letter requested that if the modification was satisfactory, the contractor sign the letter to indicate acceptance thereof and return it to the contracting officer. The cover letter apparently was a form which accompanied all modifications. Nothing in either the modification itself or in the letter was calculated to put the contractor on notice of a possible novation. The modification, if anything, achieved the opposite result by stating that the rights of the parties were not therein altered.

Defendant has, nevertheless, cited some cases which it argues support its position that the United States is not obligated as a party to the contract. For example, defendant relies on *Best* v. *United States*, 154 Ct. Cl. 827, 292 F.2d 274 (1961). In *Best*, the United States Army solicited bids for an ammunition storage area in Germany and awarded the contract to Josef Best, who later sued for breach of contract. The court, in reviewing the claim, found not only that there was not a contract (rather, a requisition of materials and labor from an occupied country), but also that any taking was done not by the United States acting in its sovereign capacity, but by the High Commission of the Allied Countries occupying Germany at the time. Even though the Army administered the contract, it had no authority to obligate the United States, which it had divulged to plaintiff, and was in any event acting as an agency of the Allied High Commission of Germany. Defendant contends that similarly the Corps of Engineers was acting as an agent of USCAR and the RDWC in administering the contract for the Tengan Dam. This argument is faulty, however, because in *Best*, the Army was affiliated for purposes of the procurement with the Allied High Commission. In the Ryukyus, the Commissioner, head of USCAR, was an appointee of the United States Department of Defense. Furthermore, the occupa-

tion was administered solely by the United States, unlike the occupation of Germany, where a joint Commission might have been said to be responsible for damages in *Best*. The RDWC was an instrumentality of USCAR under its charter. Thus, the case is factually distinct from *Best*, and we cannot say there was no authority to bind the United States under these circumstances.

Defendant also urges that an analogy should be drawn to *Porter* v. *United States*, 204 Ct. Cl. 355, 496 F.2d 583 (1974), *cert. denied*, 420 U.S. 1004 (1975), which concerned a suit against the United States Government, arising out of a sea transportation contract between plaintiffs and officials of the Trust Territory of the Pacific Islands. The court held there was no jurisdiction, and no claim against the United States, in part because the Trust Territory government was created pursuant to a United Nations Trusteeship agreement, and thus was not an instrumentality or agency of the United States for contract purposes. Again, *Porter* does not preclude us from finding that there was authority to bind the United States to the contract in the instant case. Although it appears that a trusteeship form of occupation government was originally contemplated, *see Burna* v. *United States*, *supra*, 240 F.2d at 721, as events would have it the Ryukyus were never so administered. At all times in controversy, the United States exercised full jurisdiction over the Islands, and in theory at least, was answerable neither to a joint Allied Commission nor to the United Nations. Moreover, in *Porter*, the contract was signed on behalf of the Trust Territory, and not on behalf of the defendant. The court, therefore, declined to broaden the scope of the contract so far as to hold the United States liable under it. Here, the signature of the United States on the instrument, together with the exclusivity of American control of the Ryukyus, operates to require a finding that defendant, at the time the contract was signed, intended to be bound by it.

For purposes of this decision, it is established that the RDWC was an instrumentality of USCAR, created under the mandate of Executive Order 10713, to facilitate administration of the Ryukyus. Plaintiff argues from this that the RDWC had the status of an instrumentality of the

United States proper, and was capable by itself of binding the United States Government to its own contracts. Thus the mere form did not matter. Had the contract been executed by the RDWC, or if an agency relationship had been apparent on the face of the instrument, the United States would still be liable.

The Congress, can, of course, create territorial sovereigns, of which the Government of the District of Columbia has had the longest life and is the best known. The consent to be sued, in the Tucker Act, does not normally embrace suits on the contracts of such sovereigns, even though they are beyond question instrumentalities of the United States. The theory is, perhaps, that they have their own sovereign immunity and should be the ones to waive it, if it is to be waived. Frequently, as in the case of USCAR, they have their own revenues. Non-use of United States appropriated funds in funding the activity involved in the contract is generally fatal to our jurisdiction. *McCloskey & Co.* v. *United States*, 208 Ct. Cl. 697, 530 F.2d 374 (1976) (D. C. Armory Board). Whether USCAR is a territorial sovereign of that character is a difficult issue which would have to be resolved if we should adopt the plaintiff's argument. Since the contract originally purported to bind the United States itself, not its instrumentality, the question as to the effect it would have had, if framed to bind the instrumentality, does not arise or is moot.

The *McCloskey* barrier against Tucker Act suits on the contracts of non-appropriated fund entities does not apply here because the Army Engineers had available U. S. funds appropriated directly for the Tengan Dam. Modification 13, above referred to, reveals specifically that the Engineers were drawing funds from two pockets, one the appropriated funds, the other the revenues of the RDWC. The record reveals that the many military activities on Okinawa were large users of the water. It would be strange to hold that the Engineers did not have authority to bind the United States when they were using appropriated funds to carry out an authorized project for purposes directly related to United States national defense.

The language of pertinent appropriations acts, Foreign

Aid and Related Agencies Appropriation Act, Pub. Law No. 88–258, 77 Stat. 857, 861 (1964) and Foreign Assistance and Related Agencies Appropriation Act, Pub. Law No. 88–634, 78 Stat. 1015, 1020 (1964), supports a finding that in fact funds were available for the construction of the Tengan Dam. For example, in Public Law No. 88–258, Congress stated that "$2,000,000 shall be available for transfer to the Ryukyu Domestic Water Corporation for the construction of a portion of the integrated water system." A similar appropriation of $4,000,000 was made available for the following year. The probability that Congress intended to devote appropriated funds to the water system project is further enhanced by the legislative history of Public Law 90–126 in which the Senate Committee on Armed Services acknowledged a responsibility on the part of the United States to contribute to the welfare of the people of the Ryukyus. *See* S. REP. No. 674, 90th Cong., 1st Sess. (1967). *See also*, S. REP. No. 1738, 86th Cong., 2d Sess. (1960). The thrust of the legislation passed concerning the Ryukyus, then, is that appropriated funds were not intended to be insulated from liability for contracts executed by American officials acting on behalf of the Ryukyuans.

Since the requirement is only that appropriated funds be available to satisfy contractual obligations, it is not necessary to reach the question, raised by defendant, of whether these funds were actually used. It might be noted that the clause in the Memorandum of Understanding stipulating that funds obligated by the Corps of Engineers be reimbursed by RDWC would not necessarily vitiate jurisdiction even if RDWC were not an instrumentality of the United States. This is so under the holding of *Hughes Aircraft Co.* v. *United States*, 209 Ct. Cl. 446, 534 F.2d 889 (1976). In *Hughes*, the court concluded that even where the funds expended were to be reimbursed in full by the United Kingdom, regular appropriated amounts were intended by Congress to be available pending reimbursement. This was sufficient to sustain a finding of availability of appropriated funds. 209 Ct. Cl. at 477–79, 534 F.2d at 909–11. The instant case is very similar, because even if the RDWC was expected eventually to reimburse the United States for the amounts expended in constructing the dam, pending

reimbursement, these funds were intended to be available to fulfill America's commitment to improve the Ryukyuan standard of living.

Defendant's next argument is that whether or not it was a party to the contract at its inception, it no longer was obligated under that contract once the treaty accomplishing reversion of the Ryukyus to Japan was ratified and took effect on May 15, 1972. Defendant expounds the position that this treaty cut off any rights DeMauro might theoretically have had against the United States, and left plaintiff with the sole remedy of proceeding against the government of Japan in the Japanese courts. This follows because under the treaty, Article VI, the Ryukyu Domestic Water Corporation was transferred to Japan, and the rights and obligations of the RDWC were assumed by the government of Japan.

As plaintiff states, however, the rights on which it is suing accrued prior to the reversion of Okinawa under the treaty. It is well-established law that a treaty cannot extinguish these rights. *See Board of County Commissioners* v. *Aerolineas Peruanasa*, 307 F.2d 802, 806–08 and n. 4 (5th Cir. 1962) (per Bell, J.), *cert. denied*, 371 U.S. 961 (1963). *Cf. Abbott* v. *United States*, 125 Ct. Cl. 330, 333–34, 112 F.Supp. 801, 803 (1953). This is especially so in view of the fact that nowhere in the treaty is there any suggestion that Japan is to assume these obligations. The assumption of liabilities is made with respect to RDWC and other Ryukyuan utilities created by USCAR. As stated in *Abbott, supra*, in the absence of any express intent by Congress to cut off rights, we retain jurisdiction, particularly in cases where a large portion of the claim might be lost by operation of the statute of limitations should plaintiffs be required to sue in a different forum. 125 Ct. Cl. at 334, 112 F.Supp. at 803.

To conclude, we find that defendant's arguments concerning this court's lack of jurisdiction are without merit and, as found by the Board of Contract Appeals, plaintiff is entitled to an equitable adjustment for the changed condition encountered during performance of the contract. Since defendant consistently refuses to negotiate with plaintiff, as directed by the Board, this action for breach of

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contract is properly maintainable in this court. *See Universal Ecsco Corp.* v. *United States*, 181 Ct. Cl. 10, 17–19, 385 F.2d 421, 425–26 (1967); *New York Shipbuilding Corp.* v. *United States*, 180 Ct. Cl. 446, 462, 385 F.2d 427, 436 (1967).

Accordingly, we deny defendant's motion for summary judgment and grant plaintiff's cross-motion for summary judgment on the question of liability. The case is remanded to the Trial Division for further proceedings, pursuant to Rule 131(c) to determine the quantum of recovery to which plaintiff is entitled.

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569 F.2d 565

JACOB L. PETE AND JAMES W. PETE v. THE UNITED STATES

[No. 17–72. Decided January 25, 1978]

OPINION

Eminent domain; taking; just compensation; litigation expenses; Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970; personal property.—Plaintiffs filed this inverse condemnation action seeking just compensation under the Fifth Amendment and 28 U.S.C. § 1491 for three barges located on Basswood Lake, Minnesota, and used in conjunction with operation of its shoreland as a fishing and hunting resort. Following establishment of a wilderness area (the Boundary Waters Canoe Area) along the international boundary between the United States and Canada, defendant condemned all privately owned property under its jurisdiction in the Area, including plaintiffs' land. The barges could not be moved intact overland and the cost of dismantling would approximate construction of new barges. In a decision reported at 209 Ct. Cl. 270, 531 F. 2d 1018 (1976), this court held that plaintiffs were entitled to $153,000 as just compensation for the taking of the barges plus interest pursuant to law, and costs, the amounts to be determined under Rule 131(c). Pursuant to the parties' stipulation, it was agreed that the appropriate interest rate is 6% and that plaintiffs incurred reasonable attorney fees, costs and disbursements of $31,293.79. However, defendant reserved its right to question jurisdiction of the court to award the fees and costs since a taking of *personal* property is involved, in view of 42 U.S.C. § 4654 which, according to defendant, only authorizes award of litigation expenses in an inverse condemnation action involving *real* property. It is *held* that plaintiffs are entitled under Sec. 4654(c) to recover the litigation expenses in connection with the taking of the barges in accordance with the stipulation. Sec. 4654(c) which concerns inverse

condemnation actions, specifically omits any limitation as to the type of property—real or personal. Judgment is entered for plaintiffs for $153,000 as just compensation for the taking of the barges, and for $31,293.79 for litigation expenses, making a total of $184,293.79. Also, plaintiffs shall recover a sum computed at the rate of 6% per annum on the $153,000 from the date of taking to the date of payment as a part of just compensation.

Eminent domain; just compensation; inverse condemnation; litigation expenses; personal property.

[1] The fact that Sec. 4654(a) of 42 U.S.C. was expressly limited to certain condemnations of "real" property, while Sec. 4654(c), concerning inverse condemnation actions, specifically omits the word "real" as a modifier of "property," clearly demonstrates that Congress understood the difference between the types of actions and intended to permit recovery of litigation expenses by a successful property owner in an inverse condemnation action for the taking of his property, real or personal, by a federal agency, while denying recovery of such expenses in the normal condemnation proceedings, particularly when the nature of the two actions is considered.

Eminent Domain ⇨265(1), 316

Ernest I. Reveal, for plaintiffs; *Solly Robins,* attorney of record. *Robins, Davis & Lyons,* of counsel.

E. Lawrence Hannaway, with whom was *Assistant Attorney General James W. Moorman,* for defendant. *Herbert Pittle,* of counsel.

Before DAVIS and KASHIWA, *Judges.**

KASHIWA, *Judge,* delivered the opinion of the court:

The sole issue presented in this case is whether section 304(c) of the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, 42 U.S.C. § 4654(c) (1970), authorizes the payment of litigation expenses by the United States in an inverse condemnation action involving personal, as opposed to real, property. After consideration of the briefs and oral arguments presented, we find that plaintiffs are entitled to recover appropriate litigation expenses under that statute.

This case is the latest in a protracted line of litigation on defendant's liability for the alleged taking of three cabin barges or large houseboats belonging to plaintiffs.[1] The

* Senior Judge Durfee participated at oral argument but passed away before final decision was made in this case.

[1] The district court's opinion in *United States* v. *967.905 Acres of Land,* 305 F.

United States and Canada had established a wilderness area along the international boundary between the two countries. This area, called the Boundary Waters Canoe Area, covers approximately four million acres and includes numerous lakes, rivers, and creeks. Commercial activities were prohibited. The United States condemned all privately owned property under its jurisdiction in the Boundary Waters Canoe Area, including two separate tracts of land owned by plaintiffs (the condemnees in the district court action). Plaintiffs sought to receive compensation for the value of the three barges used in their business, claiming that these barges were rendered useless and that relocation was not feasible. In *United States* v. *967.905 Acres of Land, supra* note 1,[2] the court held that the barges were fixtures, thus entitling the condemnees to compensation for their value. The Eighth Circuit, however, reversed the district court, holding that the barges could not properly be characterized as real estate. *United States* v. *967.905 Acres of Land,* 447 F. 2d 764, 769 (8th Cir. 1971), *cert. denied,* 405 U.S. 974 (1972). Consequently the condemnees were denied compensation for these personal property items, since the eminent domain proceeding brought by the Government was limited to real property.

Plaintiffs subsequently filed an inverse condemnation action in this court, seeking just compensation for the barges under the Fifth Amendment and 28 U.S.C. § 1491 (1970). On March 17, 1976, the court adopted the recommended opinion of Trial Judge Charlotte P. Murphy and held that plaintiffs were entitled to $153,000 as just compensation for the taking of the three barges, plus "interest pursuant to law, and costs, with these amounts to be determined under Rule 131(c)." *Pete* v. *United States,* 209 Ct. Cl. 270, 300, 531 F. 2d 1018, 1036 (1976).

The parties have stipulated and agreed that the appropriate interest rate in this case is 6 percent and that plaintiffs have incurred reasonable attorney fees, costs, and

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Supp. 83, 84–87 (D. Minn. 1969), provides a detailed summation of the facts, which we need not repeat in full.

[2] Following this decision, the district court ordered a new trial which, for purposes of the instant case, reached the same result as that reported at 305 F. Supp. 83.

disbursements in the total amount of $31,293.79 in connection with this litigation. In agreeing to the reasonableness of such costs, however, defendant "reserve[d] its right to question the jurisdiction of the Court to award such fees and costs in this case which involves a taking of personal - not real property," notwithstanding this court's March 17, 1976, opinion.

42 U.S.C. § 4654 (1970) provides:

Litigation Expenses

(a) The Federal court having jurisdiction of a proceeding instituted by a Federal agency to acquire real property by condemnation shall award the owner of any right, or title to, or interest in, such real property such sum as will in the opinion of the court reimburse such owner for his reasonable costs, disbursements, and expenses, including reasonable attorney, appraisal, and engineering fees, actually incurred because of the condemnation proceedings, if—

(1) the final judgment is that the Federal agency cannot acquire the real property by condemnation; or

(2) the proceeding is abandoned by the United States.

(b) Any award made pursuant to subsection (a) of this section shall be paid by the head of the Federal agency for whose benefit the condemnation proceedings was instituted.

(c) The court rendering a judgment for the plaintiff in a proceeding brought under section 1346(a)(2) or 1491 of Title 28, awarding compensation for the taking of property by a Federal agency, or the Attorney General effecting a settlement of any such proceeding, shall determine and award or allow to such plaintiff, as a part of such judgment or settlement, such sum as will in the opinion of the court or the Attorney General reimburse such plaintiff for his reasonable costs, disbursements, and expenses, including reasonable attorney, appraisal, and engineering fees, actually incurred because of such proceeding.

Defendant contends that section 4654(c) only authorizes the award of litigation expenses in an inverse condemnation action involving *real* property and that Congress, in enacting this statute, did not intend to allow the award of litigation expenses for the taking of *personal* property. Defendant's position is premised on the argument that the whole tenor of the Uniform Relocation Assistance and Real

Property Acquisition Policies Act of 1970, 42 U.S.C. §§ 4601–4655 (1970), deals with the taking by the United States of real property. Not only does the title of the Act itself refer to "real property," but subchapter III (§§ 4651–4655) is entitled "Uniform Real Property Acquisition Policy." Finally, defendant cites the legislative history[3] of section 4654 in support of this interpretation of the statute.[4]

What defendant does not account for, however, is the fact that section 4654(c), concerning inverse condemnation actions, specifically omits the word "real" as a modifier for "property." Section 4654(a), by way of contrast, specifically limits recovery of litigation expenses in eminent domain proceedings (where the final judgment is that the Government cannot acquire the real property by condemnation or the proceeding is abandoned by the United States) instituted by a federal agency to situations involving the acquisition of "real property." Thus, for us to agree with the defendant's interpretation of section 4654(c), we must conclude that Congress accidently omitted the word "real" from section 4654(c).

We cannot agree with defendant that the omission of the word "real" from section 4654(c) was merely due to Congressional inadvertence. The fact that section 4654(a) was expressly limited to certain condemnations of "real" property, while section 4654(c) was not so limited, clearly demonstrates to us that Congress understood the difference

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[3] The legislative history of section 304 of the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, 42 U.S.C. § 4654 (1970), states:

> Section 304 would authorize the reimbursement of owner of any right, or title to, or interest in real property for reasonable expenses of litigation, including legal, appraisal and engineering fees, actually incurred because of the taking of real property by Federal agencies, where (1) the court determines that a condemnation was unauthorized, (2) the Government abandons a condemnation, or (3) a property owner brings an action in the nature of inverse condemnation and obtains an award of compensation. (Tucker Act)
>
> Ordinarily the Government should not be required to pay expenses incurred by property owners in connection with condemnation proceedings. The invitation to increased litigation is evident. [H.R. Rep. No. 91–1656, 91st Cong., 2d Sess. (1970), *reprinted in* [1970] U.S. Code Cong. & Ad. News 5850, 5874–75.]

[4] In supplemental briefs filed in this case, defendant conceded that § 306 of the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, Pub. L. 91-646, 84 Stat. 1907 did not present a separate defense to plaintiffs' claim. See also *Drakes Bay Land Co.* v. *United States*, 198 Ct. Cl. 506, 521–522, 459 F. 2d 504, 512 (1972).

between the types of actions. It also demonstrates to us that Congress intended to be more generous in allowing costs in inverse condemnation cases. Nor does our reading of the legislative history of section 4654 lead to a contrary conclusion.

The reasoning behind Congress' decision, as evidenced in section 4654, to permit recovery of litigation expenses in an inverse condemnation action for the taking of property, real or personal, by a federal agency, while denying recovery of litigation expenses in the normal condemnation proceeding, becomes even more apparent when the natures of these two actions are considered. The regular eminent domain proceeding is essentially a one-step proceeding for purposes of litigation expenses: a determination of the amount of compensation due the condemnee for his property. No exhaustive proceedings on the Government's obligation to pay for the property (akin to a trial on liability in an inverse condemnation action) are normally required. By filing a declaration of taking, the Government admits its obligation to compensate the owner for the property taken.

In contrast, an inverse condemnation proceeding is a two-step process. The plaintiff must first institute an action and establish the fact of a taking, the existence of which the Government denies. Only if successful on this first step can the plaintiff advance to the quantum stage to determine the value of the property for purposes of compensation. It is inevitable that the successful plaintiff in the two-step inverse condemnation action will be forced to pay greater litigation expenses than would have been necessary if the federal agency had properly performed its function and condemned the property in question. Congress sought to rectify this situation through section 4654 by allowing recovery of litigation expenses for a successful plaintiff in an inverse condemnation action.

Nor can we discern any rational basis for limiting the allowance of costs in inverse condemnation suits to inverse condemnations of "real property." An inverse condemnation suit involving "personal property" is identical in every respect to an inverse condemnation suit involving real property. The same two-step proceeding must be instituted

Syllabus

by the aggrieved personal property owner. He must overcome the same obstacle of first establishing a taking, before he can proceed to proving his just compensation. Because of this, it is clear that an aggrieved personal property owner would have identical legal costs in vindicating his property rights as an owner of real property. Therefore, we cannot agree with defendant that Congress intended in section 4654(c) to treat identically situated property owners so disparately.

Accordingly, for the foregoing reasons, we hold that plaintiffs are entitled under 42 U.S.C. § 4654(c) to recovery of litigation expenses in a successful inverse condemnation action for the taking by a federal agency of their personal property.

In accordance with the opinion of this court in *Pete* v. *United States*, 209 Ct. Cl. 270, 531 F. 2d 1018 (1976) and the stipulations of the parties, judgment is entered for the plaintiffs in the sum of $153,000 as just compensation for the taking of their barges and in accordance with the foregoing opinion judgment is entered for the plaintiffs in the sum of $31,293.79 for litigation expenses making a total of $184,293.79. In addition, plaintiffs shall recover a sum computed at the rate of six percent (6%) per annum on the $153,000 from the date of taking (January 19, 1966) until the date of payment as a part of just compensation.

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568 F.2d 1329

JACK E. BARTH & WILLIAM LEVINE v. THE UNITED STATES

[No. 349–74. Decided January 25, 1978]

ON DEFENDANT'S AND PLAINTIFFS' MOTIONS FOR SUMMARY JUDGMENT

Civilian pay; overtime and night differential pay; travel status.—Plaintiffs, civilian Navy Department employees, were, for a period of time, directed to report to a test site some 40 miles from their assigned duty station. They were provided free use of a Government car or transportation allowances and reimbursable expenses, as well as per diem. They claim overtime and night differential pay for the 1 hour driving time each way between the duty station and the test site occurring before and after their regular day or evening shifts. It is *held*

that the facts of this case do not bring plaintiffs' travel within the statutory exception to the general rule that travel time is not considered hours of compensable employment, i.e. the relevant exception of 5 U.S.C. § 5542(b)(2)(B)(iv) that the travel results from an event which could not be scheduled or controlled administratively. Plaintiffs reported routinely to the test site according to a regularly maintained schedule prepared in advance; when plaintiffs were required to extend their regular work period they received overtime pay for the additional time actually spent at the test site. Plaintiffs' motion for summary judgment is denied, defendant's motion is granted and judgment is entered for defendant.

Civilian pay; overtime pay; travel time.

[1] Travel which has no purpose other than to transport an employee to and from the place where he performs his duties is not work and is not compensable as overtime, unless the travel falls within the exceptions of 5 U.S.C. § 5542(b)(2)(A) and (B). Where plaintiffs' work shifts at the test site outside their duty station were scheduled administratively and were predictable, plaintiffs traveled to and from the test site over periods of several weeks, the starting and finishing times of their duty shifts were set by the Navy and remained constant, and the private test contractor advised the Navy sufficiently in advance of a test phase to enable the Navy to schedule personnel on monitoring shifts, the travel to and from the test site cannot be considered compensable overtime within the relevant exception of 5 U.S.C. § 5542(b)(2)(B)(iv). This is so even though the Navy shared control of the testing "event" with the contractor and exercised its control indirectly.

Armed Services ⚖27

Courts; judicial powers and functions; encroachment on legislature.

[2] Since Congress has affirmatively prohibited an award of overtime pay for travel time unless the statutory exceptions of 5 U.S.C. § 5542(b)(2)(A) and (B) are met, the courts have no power to rewrite the statute to provide a remedy satisfactory to all, but are bound to apply the statute as written.

United States ⚖39(4)

John I. Heise, Jr., for plaintiffs. *Heise, Jorgensen & Stefanelli P.A.*, of counsel.

Anthony Thompson, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before COWEN, *Senior Judge*, DAVIS and KUNZIG, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court:

This civilian pay case is before the court on cross-motions for summary judgment. Jack E. Barth and William Levine (plaintiffs), civilian employees of the Department of the

Navy, were, for a period of time, directed to report to a test site some 40 miles away from their assigned duty station. They claim entitlement to overtime and night differential pay for time spent in travel status between the duty station and the test site (i.e., driving time each duty day prior to reaching the site for a regular work shift and again upon the conclusion of the shift). The general rule is that travel time is not considered hours of employment. We hold that the facts of this case do not bring plaintiffs' travel within the peculiar language of the narrowly drawn statutory exception to this rule.

This suit covers a period of time, commencing in 1971 and continuing through 1972, during which the plaintiffs were directed by the Navy to observe, monitor and evaluate the results of tests on a weapons system which were being conducted by the Sperry Rand Company under a contract with the Government. Throughout the time in question, plaintiffs traveled between Great Neck, New York (the duty station) and Ronkonkoma (the test site). Plaintiffs reported routinely to Ronkonkoma, according to a schedule prepared in advance, where they worked regular shifts either from 8:00 AM to 4:30 PM or from 4:00 PM to 12:30 AM. That regular schedule was maintained without variance though sometimes, of course, plaintiffs were required to remain later and, on rare occasion, arrive earlier; in such instances they received overtime pay for the additional time actually spent at the test site.

Plaintiffs were, as a rule, provided with free use of a Government car for the trip and when one was not available, plaintiffs received transportation allowances and reimbursable expenses. Plaintiffs also received *per diem* allowances every time they went to Ronkonkoma. In this manner, apart from salaries and use of Government transportation, each plaintiff was paid in excess of $800.

In addition to the allowances and expenses already received, Barth and Levine seek overtime and night differential for that time spent in travel status to and from Ronkonkoma.[1] Plaintiff Barth sought to have his travel

[1] Ronkonkoma is approximately 40 miles from Great Neck. The driving time is about one hour each way. Plaintiffs are thus seeking overtime pay for two hours spent on the road each day that they went to Ronkonkoma, e.g., the hours 7:00–8:00

time reclassified as hours of employment in a claim which was rejected by the General Accounting Office on April 23, 1973. Plaintiff Levine made a similar claim to the Naval Plant Representative Office at Great Neck, and it was similarly rejected in November 1973.

Plaintiffs filed their petition in this court on September 25, 1974. The pay claim (amounting to more than $2000 each) is based on the Federal Employees Pay Act of 1945, as amended. 5 U.S.C. § 5542 and § 5545 (1970). Section 5542 establishes overtime pay rates and sets up both the general rule re travel time and its exceptions. The specific portion of the Act which governs this case is 5 U.S.C. § 5542(b)(2)(B)(iv)(1970)[2] (the statutory exception).

The Government argues that travel time is generally not compensable. The only circumstances in which time spent in travel status may be counted as hours of employment are those provided for by Congress in the statutory exception. The relevant exception requires that the travel result "from an event which could not be *scheduled* or *controlled* administratively." 5 U.S.C. § 5542(b)(2)(B)(iv) (emphasis added). Defendant contends that the work shift certainly was scheduled administratively throughout the period in question and further maintains that the testing "event" itself was at least partially controlled administratively. The Government concludes that plaintiffs simply do not fit under the statutory exception and that plaintiffs' claim must, therefore, be denied.

AM and 4:30–5:30 PM which bracket the regular 8:00 to 4:30 PM shift of duty and the corresponding travel hours for the evening shift.

[2] 5 U.S.C. § 5542(b)(2)(B)(iv) provides in pertinent part:

5542 overtime rates; computation

* * *

(b) For the purpose of this subchapter—

* * *

(2) time spent in a travel status away from the official-duty station of an employee is not hours of employment unless—

* * *

(B) the travel . . . (iv) results from an event which could not be scheduled or controlled administratively.

It thus creates an exception to the general rule that commuting time is noncompensable.

Plaintiffs respond by focusing attention on the Sperry Rand Company, the private contractor which actually performed the tests. Plaintiffs' view is that, where a private contractor runs the testing, as in this case, "control" of the "event" necessarily passes out of the hands of the agency. According to this view, plaintiffs assert that their travel time qualifies as hours of employment since it results from an event not "controlled administratively."

After fully considering plaintiffs' contentions, we nonetheless hold for defendant. Our starting point is the proposition that travel which has no purpose other than to transport an employee to and from the place where he is to perform his duties is not work and is not compensable as overtime, e.g., *Ayres* v. *United States*, 186 Ct. Cl. 350 (1968); *Biggs* v. *United States*, 152 Ct. Cl. 545, 287 F.2d 908 (1961); *Ahearn* v. *United States*, 142 Ct.Cl. 309 (1958), *cert. denied*, 364 U.S. 932 (1961).[3] That basic rule is currently reflected in the Federal Employees Pay Act, 5 U.S.C. § 5542(b)(2) and is subject only to those exceptions now codified at § 5542(b)(2)(A) and (B). The ground rules long established continue to apply; plaintiffs, if they are to recover, must come within a statutory exception. Plaintiffs do not do so here.

The work shifts at Ronkonkoma were scheduled administratively. Plaintiffs traveled to and from the test site over periods of several weeks. The starting and finishing times of their duty shifts were set by the Navy and remained constant. The contractor advised the Navy sufficiently in advance of any test phase so that the Navy was able to schedule personnel on monitoring shifts. Such scheduling of plaintiffs' travel was predictable and planned by the agency. It is beyond question that plaintiffs' travel was in response to a wholly foreseeable directive and that they, in fact, went to work at the same place at the same time over a period of weeks and months. In this regard they were much like any other commuters and certainly not within the "could not be scheduled" portion of the statute upon which they must rely.

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[3] For a prior analysis by this court of federal overtime problems, *see Baylor* v. *United States*, 198 Ct.Cl. 331 (1972).

Turning to the "could not be controlled" portion of the statute, we agree with defendant that this case presents a middle situation with respect to control of the testing "event." While this is not an instance of total control by the Government, neither is it one where there is a total lack of Government control (which the exception requires). This is, instead, an intermediate case where the agency shares control with the contractor and exercises its control indirectly.

It is clear that the testing "event" was administratively controllable to some extent. Plaintiffs make much of defendant's admission that the scheduling of the tests may not have been "technically" within the Government's control because the testing was actually performed by the contractor. Even so, the testing remained controllable by the Government in certain essential aspects. The testing was conducted by Sperry Rand under contract with the Government. The contractor advised the Navy of its planned test dates well in advance of the projected "events." And, on those days when "events" did occur, the contractor was not at liberty to run its tests free from all constraints, but was cognizant of the Navy requirements that called for the testing to be observed by the Navy's civilian engineers. As those engineers were only on duty shifts at Ronkonkoma between 8:00 AM and 12:30 AM, the inference is compelling that the tests were to be run inside those hours and that the contractor was thus subject to administratively imposed controls. Of course it happened that testing sometimes unexpectedly took place outside the scheduled hours. But such rare instances do not indicate the absence of Government control, indeed, just the opposite—the unusual nature of such incidents tend to show that administrative control over the "event" was pervasive even though indirect.

The time that plaintiffs spent in travel status away from their official duty station resulted from an event which was both *scheduled* and *controlled* (albeit indirectly) by their agency. Such travel time does not meet the conditions of the narrowly drawn statutory exception and, therefore, by

the unambiguous dictate of the statute, cannot be considered hours of employment.[4]

Though we may perhaps sympathize with the plaintiffs in this case, we are bound to apply the statute as we find it written. The current statutory scheme does not permit us to compensate the plaintiffs. Though we are aware that Congress has exhorted the agencies to schedule travel time so that it occurs within the work shift, 5 U.S.C. § 6101(b)(2) (1970),[5] sometimes this is impossible. Yet Congress, far from providing a remedy, has affirmatively prohibited an award of overtime pay for travel time unless the peculiar conditions of the statutory exception are met. No doubt it would be a difficult task to draft a provision which is more realistic and yet avoids the Lewis Carrollian result of paying all federal employees to drive to work. But such a task, quite properly, does not lie within the power of the judiciary; it lies with the legislature. To achieve what they desire, plaintiffs must obtain appropriate statutory amendments from the only body so empowered, Congress. In summary, we have held that the time these plaintiffs spent in travel status away from their official duty station does not fit within the language of the statutory exception. As a result, we must apply the general rule that travel time is not considered hours of employment and is not compensable.

Accordingly, plaintiffs' cross-motion for summary judgment is denied. Defendant's motion for summary judgment is granted, and judgment is hereby entered for defendant.

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[4] Nor do the implementing regulations offer any support to plaintiffs. The statutory exception is repeated without embellishment at 5 C.F.R. § 550.112(e)(2)(iv). Neither do the examples provided in the Federal Pay Manual (FPM) as an aid in applying 550.112(e) support plaintiffs' position. In fact, one example that is somewhat analagous goes the other way. Case No. 3, FPM Supp. 990–1 § 550–8.04 (advising that "although the number of people calling at a [Social Security Administration] contact station cannot be controlled or scheduled, the contact station hours could be scheduled.").

[5] § 6101. Basic 40-hour workweek; work schedules; regulations

* * *

(b) * * *

(2) To the maximum extent practicable, the head of an agency shall schedule the time to be spent by an employee in a travel status away from his official duty station within the regularly scheduled workweek of the employee.

568 F.2d 1333

TRANSCOUNTRY PACKING CO., INC. v. THE UNITED STATES

[No. 330–76. Decided January 25, 1978]

ON DEFENDANT'S MOTION FOR JUDGMENT ON THE PLEADINGS AND PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

Contracts; suspension from contracting; basis for implied-in-fact contract; Court of Claims jurisdiction; compliance with regulations.—Plaintiff seeks damages allegedly incurred due to its suspension from contracting and a bid rejection by Defense Supply Agency (DSA). Plaintiff was formed to take advantage of the potential business opportunity presented by cessation of operations, due to meat procurement irregularities, of a firm (G & G) from which DSA purchased meat products. During a preaward survey, DSA identified two individuals (Ravasini and Johnson, former employees of G & G), holding responsible key positions with plaintiff and as to whom they indicated no objection during the survey. On March 17, 1976 plaintiff was awarded a meat supply contract, which award, pursuant to 32 C.F.R. § 1–904.1, signified that plaintiff was a responsible contractor within the meaning of 32 C.F.R. § 1–902. Plaintiff then finalized earlier contingent arrangements to lease G & G's former premises, to purchase G & G equipment and to enter into a union labor agreement. On April 2, 1976, however, plaintiff was advised that a second contract on which it was low bidder was to be awarded to another bidder because plaintiff was considered nonresponsible, and that pursuant to 32 C.F.R. § 1–605 it was to be suspended from contracting with GSA along with Ravasini and Johnson. Plaintiff was suspended on April 7, 1976. Plaintiff contends that DSA's actions in granting and withdrawing its qualified contractor status were unlawful and that DSA acted arbitrarily, capriciously, without reasonable basis and in violation of relevant ASPR's. Defendant, *inter alia*, contends that the petition does not state a claim within this court's jurisdiction and upon which relief can be granted. It is *held* (1) that the implied-in-fact contract theory of *Heyer Products Co.* v. *United States*, 135 Ct. Cl. 63, 140 F. Supp. 409 (1956), and *Keco Ind., Inc.* v. *United States*, 192 Ct. Cl. 773, 428 F. 2d 1233 (1970), may not be extended to allow a successful bidder to maintain a suit on the ground that he should not have been awarded the contract; and (2) that the DSA officials did not violate regulations in determining that plaintiff was nonresponsible at the time the second bid was being awarded, for plaintiff lacked responsible key employees. Defendant's motion for judgment on the pleadings is granted

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and plaintiff's motion for summary judgment is denied. The petition is dismissed.

Contracts; contractors; responsible prospective contractor; Armed Services Procurement Regulations.

[1] Under 32 C.F.R. § 1–904.1 (1970), the award of a procurement contract to a prospective contractor by the contracting officer constitutes an affirmative determination that the contractor is "responsible" within the meaning of 32 C.F.R. § 1–902.

United States ⚖64

Court of Claims jurisdiction; generally.

[2] This court's jurisdiction is founded upon the Tucker Act which allows judgment to be rendered upon claims founded upon the Constitution, statutes, regulations or any express or implied contract; its statutory jurisdiction is limited and cannot be expanded beyond the bounds established by the Congress. Within its limited jurisdiction the court cannot base an award of damages on a statute or regulation unless it can fairly be interpreted as mandating compensation by the Federal Government.

Federal Courts ⚖1071

Contracts; implied contracts; implied in fact.

[3] This court's jurisdiction over implied contracts extends only to those implied in fact. While an invitation for bids and the bid create an implied-in-fact contract that all bids will be honestly considered by the Government and not wantonly disregarded, this implied contract theory does not extend to allow a successful bidder to maintain a suit on the grounds that he should not have been awarded the contract.

Federal Courts ⚖1077

Court of Claims jurisdiction; regulatory processes.

[4] Where federal officials have committed no wrong in the regulatory process but have merely tried to redress failures or improper activity by business entities or their employees through compulsion on those persons to comply with the proper standards, the United States cannot be held liable under the Tucker Act.

Federal Courts ⚖1073

Court of Claims jurisdiction; tort claims asserted in petition; generally.

[5] A claim that defendant did not timely inform a prospective contractor that defendant considered the contractor's employment of certain individuals as grounds for suspension from qualified bidder status, is one sounding in tort over which this court has no jurisdiction, unless the contractor can show a clear violation of the procurement regulations. The mere fact that the tortious act was intertwined with the subject bids does not convert the tort into an actionable implied-in-fact contract claim under the Tucker Act.

Federal Courts ⚖1077, 1086

Court of Claims jurisdiction; transfer to district court; exceptions to liability.

[6] Since plaintiff's claim sounds in tort and falls within either 28 U.S.C. § 2680(a) or § 2680(h) exceptions to liability under the Federal Tort Claims Act, there is no basis for transferring this case to an appropriate U.S. District Court pursuant to 28 U.S.C. § 1506.

Federal Courts ⇐1158

Frederick C. Williams, for plaintiff; *Constantine Alexander*, attorney of record. *Nutter, McClennen & Fish*, of counsel.

Vincent M. Garvey, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before LARAMORE, *Senior Judge*, NICHOLS and KASHIWA, *Judges*.

KASHIWA, *Judge*, delivered the opinion of the court:

This case is before the court on defendant's motion for judgment on the pleadings, plaintiff's opposition thereto, and plaintiff's motion for summary judgment. In its motion for judgment on the pleadings, defendant contends the petition does not state a claim within this court's jurisdiction and that it fails to state a claim upon which relief can be granted. For jurisdictional reasons, we grant defendant's motion for judgment on the pleadings and deny plaintiff's motion for summary judgment.

In this action plaintiff is seeking damages allegedly incurred by it due to the Defense Supply Agency's (DSA) suspension of plaintiff from further contracting and the rejection by DSA of a bid submitted by plaintiff.

This case stems from a 1975 meat procurement scandal involving a Boston meat packing firm which operated as G & G Packing Company, Inc. (G & G). On December 8, 1975, G & G was formally suspended by DSA from further contracting with it for the supply of meat due to the fraudulent and possible criminal activities of G & G and its employees or agents. Plaintiff is a corporation which was formed in January 1976 to take advantage of the potential business opportunity presented by the cessation of operations by G & G. Soon after its formation in January 1976,

plaintiff entered into various preliminary contracts and arrangements with the landlord of the premises previously occupied by G & G, meat suppliers, the owners of the G & G equipment, and members of a union, all contingent upon plaintiff's obtaining approval by DSA as a qualified bidder for meat contracts.

During January and February 1976, a preaward survey was conducted by DSA and during this time Frank Ravasini and William Johnson[1] were identified as employees holding responsible positions with plaintiff. DSA officials made no objection to the employment of these two individuals during the preaward survey. On March 17, 1976, plaintiff was awarded contract DSA 13H–76–C–B48H for 32,000 lbs. of meat. (Hereinafter plaintiff's first bid and award will be referred to as Bid I.) Under the Armed Services Procurement Regulations, the award of this contract to plaintiff by the contracting officer constituted an affirmative determination that plaintiff was "responsible" within the meaning of 32 C.F.R. § 1–902 (1975). 32 C.F.R. § 1–904.1 (1975).

Subsequently, plaintiff submitted a second bid under RFP DSA 13H–76–R–3441, which was the low bid. (Hereinafter plaintiff's second bid will be referred to as Bid II.) On April 2, 1976, plaintiff was advised that this contract was to be awarded to another bidder because plaintiff was "nonresponsible." Further, plaintiff was advised that pursuant to 32 C.F.R. § 1–605 (1975), it was to be suspended from contracting with DSA along with Frank Ravasini and William Johnson. Plaintiff was suspended on April 7, 1976, and subsequently liquidated.

In its petition plaintiff alleges that the DSA's actions, in granting and then withdrawing plaintiff's qualified contractor status, were unlawful. Specifically, plaintiff states:

> * * * DSA knew, or ought to have known, that the investigations in progress had or would develop evidence

[1] In the pleadings and briefs, another individual, Steven Goldberg, was also involved. At oral argument defendant stated the suspension of plaintiff from qualified bidder status was in no way based upon plaintiff's relationship with Steven Goldberg. Since defendant seeks to justify its suspension of plaintiff solely on the plaintiff's relationship to Frank Ravasini and William Johnson, we do not consider whether plaintiff's relationship with Steven Goldberg would justify defendant's actions in this case.

indicating that Frank Ravasini and William Johnson would or might be implicated with complicity in the irregularities and illegal acts alleged to have been committed by G & G and its officers and some of its employees.

Plaintiff further asserts that:

> By its acts and omissions as alleged herein DSA acted arbitrarily, capriciously, without reasonable basis, and in violation of the [Armed Services Procurement Regulations], specifically 32 C.F.R. §§ 1.605, 1.605–1, and 1.605–2(b)(1) and (3), in (1) not timely informing Transcountry that it considered the employment of Ravasini and Johnson grounds for nonapproval as a qualified bidder, (2) first granting and then precipitously withdrawing approval, thereby causing Transcountry to make firm business commitments which it could not then satisfy;[2] * * * (4) precipitously withdrawing approval without allowing Transcountry a transition period of a few weeks in which to obtain replacements for the suspect employees while being able to meet business commitments which DSA's actions had induced it to make.

As a result of DSA's allegedly unlawful conduct, plaintiff contends it has damages amounting to $500,000 for the following:

> * * * for organizing expenses; for expenses incurred in undergoing preaward survey; for expenses involved in preparation of the second bid; for extra wages to employees subsequent to the first contract and prior to termination of operations; for expenses for the termination of the occupation of G & G's former premises; for loss on the contract for purchase of the machinery and equipment from G & G; for legal fees incurred in the establishment of Transcountry and during the conduct of the preaward survey; for other damages incurred in setting up Transcountry and bidding; and for the expenses and attorneys' fees resulting from the prosecution of this action.

Defendant's motion for judgment on the pleadings presents the basic question of whether the petition states a claim within the jurisdiction of this court. Since we find the jurisdictional issue controlling, we do not consider the other issues raised by the parties.

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[2] The third item involved plaintiff's relationship with Steven Goldberg which we are not concerned with here. See note 1.

This court's jurisdiction is founded upon the Tucker Act, 28 U.S.C. § 1491 (1970),[3] which allows judgment to be rendered upon claims founded upon the Constitution, statutes, regulations, or any express or implied contract. This court is a court of limited statutory jurisdiction which cannot be expanded beyond the bounds established by the Congress. *Soriano* v. *United States*, 352 U.S. 270, 273 (1957); *Carney* v. *United States*, 199 Ct. Cl. 160, 162, 462 F. 2d 1142, 1144 (1972). It does not have jurisdiction over tort claims. *Somali Development Bank* v. *United States*, 205 Ct. Cl. 741, 508 F. 2d 817 (1974). Its jurisdiction over implied contracts extends only to implied-in-fact and not implied-in-law contracts. *Merritt* v. *United States*, 267 U.S. 338, 341 (1925); *Algonac Manufacturing Co.* v. *United States*, 192 Ct. Cl. 649, 674, 428 F. 2d 1241, 1256 (1970). Although it has jurisdiction over claims founded upon statutes or regulations, it cannot base an award of damages on a statute or regulations unless it can fairly be interpreted as mandating compensation by the Federal Government. *United States* v. *Testan*, 424 U.S. 392 (1976); *Eastport Steamship Corp.* v. *United States*, 178 Ct. Cl. 599, 607, 372 F. 2d 1002, 1008–1009 (1967).

We first consider plaintiff's allegations that its claim arises out of contractual dealings with the DSA and, therefore, is within this court's jurisdiction. Plaintiff makes no allegation that its claim is based upon an express contract. Plaintiff instead relies upon a line of cases which follow an implied-in-fact contractual theory. *Heyer Products Co.* v. *United States*, 135 Ct. Cl. 63, 140 F. Supp. 409 (1956); *Keco Industries, Inc.* v. *United States*, 192 Ct. Cl. 773, 428 F. 2d 1233 (1970); *Continental Business Enterprises, Inc.* v. *United States*, 196 Ct. Cl. 627, 452 F. 2d 1016 (1971); *McCarty Corp.* v. *United States*, 204 Ct. Cl. 768, 499 F. 2d 633 (1974); *Armstrong & Armstrong, Inc.* v. *United States*, 514 F. 2d 402 (9th Cir. 1975); and *Scanwell Laboratories, Inc.* v. *Thomas*, 521 F. 2d 941 (D.C. Cir. 1975).

[3] § 1491. "The Court of Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress, or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort." • • •

In *Heyer, supra,* the plaintiff alleged the bidding procedure followed by the Government was a mere sham to conceal an intention to let the contract to a favored bidder. There, the plaintiff's bid was the low bid but was rejected and the contract was awarded to the seventh lowest bidder. This court held in *Heyer* that the invitation for bids and the bid created an implied-in-fact contract that all bids would be honestly considered by the Government and not "wantonly disregarded." Further, that if the plaintiff could prove that the Government had breached that obligation, it was entitled to recover its bid preparation costs, but not its anticipated profits. In *Keco Industries, supra,* this court extended the *Heyer* rule to situations where the Government's conduct was something less than "wanton disregard" in making the award to another contractor. There, this court stated:

> * * * [We] find that *Heyer* stated a broad general rule which is that every bidder has the right to have his bid honestly considered by the government, and if this obligation is breached, then the injured party has the right to come into court to try and prove his cause of action. [*Keco Industries, supra,* at 780, 428 F. 2d at 1237.]

We believe plaintiff's cause of action falls outside the ambit of the bid award protest cases cited above. In regard to Bid I, plaintiff was awarded the contract on March 17, 1976, in response to its bid. Plaintiff's real complaint is that defendant should not have awarded plaintiff this contract, because the DSA officials should have known that the plaintiff was "nonresponsible." We have found no case and have been cited to no case in which the *Heyer* implied contract theory has been extended to allow a successful bidder to maintain a suit on the grounds that he should not have been awarded the contract. Nor are we prepared to so extend the doctrine.

Plaintiff was the low bidder on the Bid II contract, but was not awarded the contract for it was not a responsible bidder. With regard to Bid II, plaintiff makes no contention that the DSA's determination of nonresponsibility was incorrect. In fact, plaintiff admits that Ravasini and Johnson were employed by it, that both were ultimately found to have been involved in the fraudulent and/or

criminal activities of G & G, and that both held important and responsible positions with the plaintiff. Thus, there was a clear rational basis for DSA's determination that plaintiff was nonresponsible, for it lacked responsible key employees.

Upon close analysis, plaintiff's complaint about Bid II is a mere variation of its complaint involving Bid I. Its Bid II allegation is basically that since the DSA officials should have known that plaintiff was nonresponsible at the time Bid I was awarded, and since they acted wrongly in awarding plaintiff the first contract, defendant has the duty of not precipitously revoking the qualified bidder status of plaintiff, even when there are clear grounds for the agency's finding of nonresponsibility. For this court to hold that this allegation states a claim within our jurisdiction, we would have to extend the *Heyer* and *Keco Industries* cases to a situation where a successful bidder is awarded a contract that he later claims should not have been awarded to him; thus, imposing the further obligation on the Government of not precipitously withdrawing qualified bidder status at a later date. We have already stated that we are not prepared to so extend the *Heyer* and *Keco Industries* cases.

In the alternative, plaintiff invokes this court's jurisdiction based upon DSA's alleged violation of the Armed Services Procurement Regulations. Here, plaintiff relies on the holding in *Scanwell Laboratories, Inc.* v. *Shaffer*, 424 F. 2d 859 (D.C. Cir. 1970). In *Scanwell* the plaintiff was seeking a declaratory judgment against the Federal Aviation Administration (FAA) on the ground that the FAA had violated the Federal Procurement Regulations promulgated under the Administrative Procedures Act. There, the D.C. Circuit Court of Appeals held, for the first time, that plaintiff had standing to sue the FAA for violating the procurement regulations on the basis of a private attorney general theory.[4]

In *Keco Industries, supra,* this court adopted the *Scanwell* rule. There, this court stated:

[4] In so doing, the Circuit Court undertook an extensive review of the law of standing and found that the Supreme Court case *Perkins* v. *Lukens*, 310 U.S. 113 (1940), had been legislatively overruled.

> We are persuaded by this very thorough presentation in *Scanwell* that the law, as it now stands, supports plaintiff's position, allowing it the right to maintain this action. We cannot agree with defendant's argument that *Scanwell* must be limited only to those cases in which plaintiff is seeking to void the award of a contract. The holding of *Scanwell* is *broad enough to grant standing to a party seeking personal money damages* as well as to one acting as a quasi attorney general for the benefit of the public. Regardless of the fact that plaintiff in the instant case is seeking money damages, it is still requiring the government to enforce its regulations fairly and honestly and treat all bidders without discrimination. [Emphasis added.] [*Keco Industries, supra,* at 781, 428 F. 2d at 1238.]

However, we find *Scanwell* inapposite to the case before us. Here, the DSA officials did not violate the regulations in determining that plaintiff was nonresponsible at the time Bid II was being awarded, for plaintiff lacked responsible key employees.

Plaintiff's real complaint is that it should never have been awarded the first contract by DSA. In its brief it contends the awarding of that contract was in violation of 32 C.F.R. § 1–905.1(b) (1975).[5] However, we find nothing in the record before us to show that the DSA officials did not comply with section 1–905.1. Plaintiff does not allege that prior to the award of the Bid I contract defendant's agents had suspended Frank Ravasini or William Johnson or that these two individuals' suspension was inevitable. Plaintiff merely asserts that because Ravasini and Johnson had both held key positions with G & G and since G & G was suspended and a criminal investigation instituted involving G & G's activities, defendant should have known that plaintiff had bad employees which would make it nonresponsible.

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[5] "1–905.1 *General.*

* * * * *

"(b) Maximum practicable use shall be made of currently valid information on file or within the knowledge of personnel in the Department of Defense. Each Department, shall at such level and manner as it deems appropriate, maintain useful records and experience data for the guidance of contracting officers in the placement of new procurement, and shall inform its contracting officers and the other Departments of the means of access thereto. Notwithstanding this direction contract administration offices shall maintain files of information reflecting upon the ability of contractors to perform Government contracts successfully."

The gist of plaintiff's claim is that defendant did not timely inform plaintiff that defendant considered the employment of Ravasini and Johnson grounds for nonapproval as a qualified bidder. As such, plaintiff's claim clearly smacks of tort over which this court has no jurisdiction. *Eastport Steamship Corp.* v. *United States, supra,* at 608–11, 372 F. 2d at 1009–1011; *Trone* v. *United States,* 213 Ct. Cl. 671, *cert. denied,* 434 U. S. 821 (1977). In *Trone,* we clearly stated:

> We have ruled that the United States cannot be held liable under the Tucker Act for commercial injuries resulting from a failure or wrong in the course of the normal regulatory process. *Eastport Steamship Corp.* v. *United States, supra,* 178 Ct. Cl. 599, 608–11, 372 F.2d 1002, 1009–1011 (1967). *A fortiori* the same principle must apply when the federal officials have committed no such wrong in the regulatory process but have merely tried to redress failures or improper activity by business entities through compulsion on those persons to comply with the proper standards.

This court in the case of *Somali Development Bank* v. *United States, supra,* held that it does not have jurisdiction over tort claims which it defined as including claims based on "negligent misrepresentation, wrongful inducement, or the careless performance of a duty allegedly owed." *Somali Development Bank, supra,* at 749, 508 F. 2d at 821. As in *Somali Development Bank,* plaintiff's petition clearly sounds in tort. The tortious acts were allegedly committed by defendant during the events occurring just prior to defendant's awarding the Bid I contract to plaintiff. The mere fact that the tortious acts were intertwined with Bid I and Bid II does not convert the tort into an actionable implied-in-fact contract claim within the jurisdiction of this court. We also observe that the very nature of the following damages claimed by plaintiff, in paragraph 27 of its petition, clearly reflects that plaintiff's petition is in tort:

> 1) Extra wages to employees subsequent to the first contract and prior to the termination of employees;
> 2) Expenses for the termination of the occupation of G & G's former premises;

3) Loss on the contract for the purchase of the machinery from G & G; and
4) Organizing expenses of plaintiff corporation.

These claims represent damages flowing from conditional obligations incurred by plaintiff before Bid I was accepted. They are not attributable to the rejection of Bid II.

Since the claim sounds in tort and falls within either 28 U.S.C. § 2680(a) (1970) or 28 U.S.C. § 2680(h) (1970), exceptions to liability under the Federal Tort Claims Act, there is no basis for transferring this case to an appropriate U.S. District Court pursuant to 28 U.S.C. § 1506 (1970).

Accordingly, based upon the foregoing, defendant's motion for judgment on the pleadings is granted and plaintiff's petition is dismissed. Plaintiff's motion for summary judgment is denied.

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568 F.2d 1339

BLUE CROSS ASSOCIATION & BLUE CROSS AND BLUE SHIELD OF NORTH CAROLINA v. THE UNITED STATES

[No. 454–76. Decided January 25, 1978]

ON PLAINTIFFS' AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; Medicare and CHAMPUS contracts; allocability of state franchise tax to Government contracts.—In 1970 Blue Cross Association (BCA) entered into a negotiated cost reimbursement no-fee contract with HEW to administer portions of the Medicare program, and then subcontracted with Blue Cross and Blue Shield of North Carolina (NC) to administer the program in that state. During 1967–1971 NC entered into negotiated cost reimbursement no-fee contracts with the Defense Department to administer portions of the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS). NC is subject to and paid a state franchise tax. NC charged the entire percentage of the tax to its non-Government business for rate-setting purposes, and then retroactively under its accounting system reallocated the costs to both Government and non-Government business. This reallocation of a portion of the tax to the Government contracts was denied administratively. The Contract Appeals Board held that plaintiffs were not entitled to allocate the tax measured solely by non-Government business within the state to the cost of their Government

contracts because the entire cost of the tax was recovered in the premiums collected from non-Government business. Plaintiffs seek Wunderlich Act review of the decision, contending that the tax is a cost of doing business in the state, that it benefits all lines of business and is an indirect cost properly allocable to the Government contracts. In upholding the Board's decision and on the particular facts of this case, it is *held* that plaintiffs are not entitled to recover. Plaintiffs' motion for summary judgment is denied, defendant's cross-motion is granted and judgment is entered for defendant.

Contracts; cost principles; Medicare and CHAMPUS programs; allocability of state franchise tax.

[1] Where a CHAMPUS contractor treated a state franchise tax as a direct cost of its non-Government premiums business for rate-making purposes and recovered the entire cost of the tax from its non-Government premiums, said CHAMPUS contractor and its prime contractor operating under a Medicare contract may not allocate a portion of the tax indirectly to their Government business where the record shows that the tax has already been recovered directly.

United States ⚖70(18)

Philip S. Neal, for plaintiffs. *Barron K. Grier, Edward A. Lenz, Miller & Chevalier,* of counsel.

Donnie Hoover, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant. *Jeffrey Robbins,* of counsel.

Before COWEN, *Senior Judge,* DAVIS and KUNZIG, *Judges.*

KUNZIG, *Judge,* delivered the opinion of the court:

This is a Wunderlich review case involving cost-reimbursement contracts for health care services rendered by the Blue Cross Association (BCA) and by Blue Cross and Blue Shield of North Carolina (NCBCBS) (plaintiffs). The Armed Services Board of Contract Appeals (the Board) held that North Carolina franchise taxes incurred by the plaintiffs were not properly chargeable to the Government under the contracts in question. Plaintiffs ask us to upset the Board's determination pursuant to our power of review established by the Wunderlich Act, 41 U.S.C. §§ 321–22 (1970), and the case is now before the court on cross-motions for summary judgment. For the reasons which follow, we hold for defendant (and we affirm the Board's decision).

Plaintiff NCBCBS is a non-profit corporation organized under the laws of North Carolina and having its principal place of business in Durham, North Carolina. Between the years 1967–71, plaintiff NCBCBS entered into negotiated cost reimbursement no-fee contracts (the CHAMPUS contracts) with the Department of Defense to administer portions of the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS). In 1970, plaintiff BCA entered into a negotiated cost reimbursement no-fee contract (the Medicare contract) with the Department of Health, Education and Welfare to administer portions of the Medicare program; BCA then subcontracted with NCBCBS for daily administration of the Medicare program in North Carolina.

NCBCBS is subject to a state franchise tax in the amount of one third of one percent (.33%) of its membership dues. N.C. Gen. Stat. § 57–14.[1] The taxable "membership dues" in this case included premiums collected by NCBCBS from its non-government business (premium business) and did not include any of its receipts from the cost-plus Government contracts.[2] Since NCBCBS was primarily involved in the sort of premium business which was taxable under the statute, it established in its premium rate-setting formula a

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[1] N.C. Gen. Stat. § 57–14 (in effect during the period at issue) provides:

§ 57–14. Taxation.—Every corporation subject to the provisions of this chapter is hereby declared to be a charitable and benevolent corporation and all of its funds and property shall be exempt from every State, county, district, municipal and school tax or assessment, and all other taxes and license fees, from the payment of which charitable and/or benevolent institutions are now or shall be hereafter exempt. Provided, however, nothing herein contained shall prevent or prohibit corporations subject to the provisions of this chapter from paying for services rendered by municipalities and counties. For the purpose of raising revenues sufficient to defray the expenses of the administration of this chapter, and in lieu of all other taxes, *an annual franchise or privilege tax is hereby levied upon every corporation subject to the provisions of this chapter at the rate of one third of one percent of the gross annual collections from membership dues exclusive of receipts from cost plus plans.* The General Assembly of North Carolina does hereby appropriate the sum of four thousand dollars ($4,000) annually from its general funds to be paid over to the Department of Insurance of the State for its use in the discharge of the duties by this chapter imposed upon the Commissioner of Insurance of this State. (emphasis added).

[2] Other cost-plus contracts, such as the one NCBCBS entered into with Reynolds Industries, are not relevant to this case. For ease of discussion, we will refer to NCBCBS's business as consisting of cost-plus Government contracts and non-Government premium business.

factor of .33% which represented that tax assessment. Though NCBCBS thus charged the tax to its premium business (non-Government) for rate-setting purposes, its books charged the tax (for accounting purposes) to all lines of business. This attempted allocation of a portion of the franchise tax to the Government contracts is the subject matter of the controversy here.

For the years 1969 and 1970, NCBCBS paid a total state franchise tax of $593,045. Of this sum, it allocated $9,116 to the CHAMPUS contract. For the year 1971, NCBCBS incurred a state franchise tax in the amount of $427,966 and allocated $52,587 to its subcontract with BCA (i.e., the Government Medicare contract).

All the allocations were denied administratively. The Department of Defense rendered a final decision disallowing NCBCBS's CHAMPUS charges in 1974, and the Department of Health, Education and Welfare disallowed BCA's Medicare charges in 1975. Plaintiffs appealed to the Armed Services Board of Contract Appeals in 1976.

In consolidated proceedings before the Board, the parties stipulated that the franchise tax applied to NCBCBS's premium business and that the Medicare and CHAMPUS contracts were "cost plus" programs not subject to regulation by the North Carolina Commissioner of Insurance. The Board found that the formula by which NCBCBS determined its non-Government premiums included a .33% factor for "regulation and supervision" and it found that NCBCBS recovered the franchise tax "in its entirety through the premiums collected from [plaintiffs'] non-Government business." The Board held that the state franchise tax was not an allowable cost of the Government contracts and denied plaintiffs' claim. Plaintiffs filed their petition in this court on November 5, 1976, seeking Wunderlich Act review of the Board's findings of fact and conclusions of law.

Plaintiffs contend that the North Carolina state tax is a cost of doing business in the state, benefits all lines of business, and is an indirect cost properly allocable to the Government contracts as well as to non-Government premium business. Plaintiffs maintain their inclusion of the .33% tax factor in their premium calculation formula

is not a relevant consideration. The Board below erred, plaintiffs assert, in relying on the premium formula and in concluding that plaintiffs had treated the tax as a direct cost of their premium business and had recouped it, in its entirety, from the premium business.

Defendant responds that this court need not reach the question whether the state taxes involved here are costs of the type which could be properly allocable. Defendant insists that because plaintiffs, in fact, passed the tax cost on to their non-Government membership through the rate structure and have already recovered the entire amount, plaintiffs may not now charge any part of it to the Government contracts.

This court agrees with defendant (and with the determination made by the Armed Services Board of Contract Appeals). Plaintiffs have already extracted the .33% factor from their policy holders and may not now extract it a second time from the Government.

The question whether state franchise taxes such as those imposed on plaintiffs by North Carolina might (in the abstract) be properly allocable to all lines of business, including the Government contracts, is not the issue in this case. We might well agree with plaintiffs that the franchise tax benefits the whole business and *could be* so allocated.[3] The only issue in this case, however, is whether plaintiffs *did* so allocate them. On the facts of this case, it is clear that plaintiffs did not charge the tax costs to all lines but, instead, deliberately treated them as direct costs of its premium, non-Government business and have already recovered those costs.

In establishing the premium rates for its non-Government business during the period in question, plaintiff NCBCBS included a factor of .33% which represented the "one third of one percent of the gross annual collections

[3] Plaintiffs have argued persuasively that despite the stipulations and concessions made in this case their costs are allocable under the "benefit" test which this court applied in *Lockheed Aircraft Corp.* v. *United States*, 179 Ct.Cl. 545, 375 F.2d 786 (1967). In *Lockheed*, we had occasion to review the Armed Services Procurement Regulations in determining whether a personal property tax assessed against a contractor's commercial inventory "benefitted" the entire business. We need not reach any of the legal principles announced in *Lockheed* to decide the instant case. The case now before us is distinguishable on its facts, and it is limited to those facts.

from membership dues" by which the franchise tax was measured. NCBCBS's vice-president for financial services so testified in proceedings before the Board. Plaintiffs also stipulated that the Government contracts were not subject to regulation by North Carolina. Plaintiffs cannot take issue with the Board's finding that the tax factor for State regulation and supervision was taken into account by NCBCBS in its non-Government premium structure.

Not only did NCBCBS treat the State tax as a direct cost of its non-Government premium business for rate-making purposes, but it was also successful in recovering the cost of the tax from its non-Government premiums. NCBCBS's vice-president for financial services conceded on cross-examination that the tax was so recovered. The Board's resultant finding that the tax was wholly recovered from plaintiffs' non-Government business is, thus, supported by strong evidence in the record.

Plaintiffs cannot (and do not) convince us that, on this record, the Board's findings of fact are arbitrary, capricious, or not supported by substantial evidence. Plaintiffs make much of their book allocations of the franchise tax and state that, under their accounting system, they did allocate the cost to all lines of business. We have no doubt that the Board considered the internal accounting methods used by NCBCBS and then properly relied on the rate structure as evidence of contrary treatment. (Indeed, the Board noted that no book allocations were made at all until 1971, at which time plaintiff made a Medicare allocation and retroactive CHAMPUS allocations.) Because the Board correctly relied on testimony in the record to support its conclusion that the tax was recovered, this court will not upset that determination on the accounting grounds which plaintiffs now advance. The Board's decision withstands Wunderlich Act review and is final and conclusive.

In summary, we have held that the Board did not err in the proceedings involved here. Plaintiffs made a deliberate and conscious attempt to recover the tax in its entirety from its non-Government business and succeeded. They charged it and recouped it from non-Government business; plaintiffs may not now recover it again from the Government.

Syllabus

Accordingly, plaintiffs' motion for summary judgment is denied. Defendant's cross-motion for summary judgment is granted, and judgment is hereby entered for defendant.

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569 F.2d 562

ALLIED MATERIALS & EQUIPMENT CO., INC. v. THE UNITED STATES

[No. 342–75. Decided January 25, 1978]

ON PLAINTIFF'S MOTION FOR REHEARING EN BANC

Contracts; breach; cardinal change doctrine; scope; extent of recovery.—Plaintiff entered into two contracts with the Army, one to supply armored-tank engine components, and the other to obtain access to sufficient Government-owned tools and a facility to perform the supply contract. Shortly thereafter General Services Administration sold the facility to another, and failed to reserve for plaintiff the right to continue using the facility, access to which was denied plaintiff by the purchaser. Plaintiff filed the present suit to recover anticipatory profits, etc., claiming contract breach. By order entered September 30, 1977, *post* at 902, the court denied the parties' motions for summary judgment and remanded the case to the trial division for proceedings to determine, *inter alia*, whether the sale effected a cardinal change constituting breach of contract. Plaintiff has moved for rehearing *en banc*; both parties have questioned the propriety of framing the issue in terms of a cardinal change. Defendant contends that the cardinal change doctrine applies only when a plaintiff seeks extra costs incurred because of a deviation from contract terms, but which are not recoverable under the contract. Plaintiff's opposition is apparently based on the belief that the doctrine applies only to deviations specifically within the conventional changes clause, and here we have a separate clause pertaining to Government-furnished property. It is *held* that if a contractor has been prevented from performing by a cardinal change, the award of anticipatory profits is an appropriate remedy, provided he shows a breach not remediable by an equitable adjustment under the contract. Since the Board did not consider whether the sale constituted a cardinal change, defendant should be afforded the opportunity to present relevant evidence on this issue to the trial judge on remand, and may also present evidence in opposition to plaintiff's charge of bad faith in terminating the contract. Plaintiff's

Syllabus

motion is denied, and the case is remanded to the trial division for further proceedings pursuant to the court's prior order.

Contracts; breach; changes outside scope of contract; cardinal change doctrine; when applicable.

[1] A cardinal change is one so profound that it constitutes a breach of contract, and occurs when the Government effects an alteration in the contractual undertaking so drastic that it effectively requires the contractor to perform duties materially different from those originally bargained for.

United States ⚖70(24)

Contracts; breach; changes outside scope of contract; cardinal change doctrine; extent of recovery.

[2] The cardinal change concept's applicability is not dictated by the nature of damages sought by the contractor; the concept may embrace in addition to a suit for extra costs incurred in performing work fundamentally outside the scope of the contract, a suit for anticipated profits and lost revenues where the contractor has been prevented from performing, as in a breach case, and the contract has been terminated for convenience of the Government.

United States ⚖74(15)

Contracts; breach; changes outside scope of contract; cardinal change doctrine; scope.

[3] The cardinal change doctrine is not so restrictive that it applies only to deviations specifically within the conventional changes clause. The doctrine is couched in terms which apply generally to modifications which are so fundamental that they cannot be redressed within the contract by an equitable adjustment to the contract price, whether under the Government-furnished property clause, the traditional changes clause, or any other.

United States ⚖70(24)

Contracts; breach; changes outside scope of contract; cardinal change; what constitutes.

[4] The existence of a cardinal change is principally a question of fact, requiring that each case be analyzed individually in light of the totality of circumstances.

United States ⚖70(22)

Charles E. Raley, attorney of record for plaintiff. *Israel and Raley,* of counsel.

Robert M. Hollis, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before NICHOLS, *Judge,* Presiding, KASHIWA and BENNETT, *Judges.*

PER CURIAM: In an order of September 30, 1977 *post* at 902, the court denied defendant's motion and plaintiff's cross-motion for summary judgment, and remanded the case to the Trial Division. Plaintiff has now moved for a rehearing *en banc* of its cross-motion for summary judgment. Defendant has filed a brief in opposition.

Briefly, this action was brought to recover anticipatory profits and more on the ground that defendant breached a contract under which plaintiff was to supply cylinder assemblies to the Army. The alleged breach was accomplished by defendant's sale to a competitor of certain tooling equipment which was contractually obligated for use by plaintiff in performing the contract. Oral argument was heard on June 6, 1977, after which the aforementioned order was issued, remanding the case for further development of certain issues by the trial judge. In particular, we instructed the trial judge to determine whether defendant's sale of the production equipment had effected a cardinal change in the contract, within the meaning of such precedents as, *e.g.*, *Edward R. Marden Corp.* v. *United States*, 194 Ct. Cl. 799, 442 F.2d 364 (1971) and *Air-A-Plane Corp.* v. *United States*, 187 Ct. Cl. 269, 408 F.2d 1030 (1969). If the trial judge found that there was a cardinal change, thus providing this court with jurisdiction, he was then to determine whether the government was dealing in bad faith prior to and in effecting the termination for convenience.

Both parties have questioned the propriety of framing the issue as whether the sale of equipment was a cardinal change. The court's instructions to the trial judge were not inadvertent, and our position will be further explained in response to each party's contentions.

It is defendant's position that the cardinal change doctrine applies only when a plaintiff seeks extra costs incurred because of a deviation from contract terms, but which are not recoverable under the contract. Defendant states that the cardinal change principle is "obviously irrelevant where plaintiff is instead seeking anticipated profits and lost revenues." Inherent in this statement, however, is the fallacious assumption that the cardinal change concept's applicability is dictated by the nature of

damages sought by a plaintiff. This is simply not so. Under established case law, a cardinal change is a breach. It occurs when the government effects an alteration in the work so drastic that it effectively requires the contractor to perform duties materially different from those originally bargained for. By definition, then, a cardinal change is so profound that it is not redressable under the contract, and thus renders the government in breach. *See, e.g., Edward R. Marden Corp.* v. *United States, supra,* 194 Ct. Cl. at 808, 442 F.2d at 369; *Air-A-Plane Corp.* v. *United States, supra,* 187 Ct. Cl. at 275–76, 408 F.2d at 1033; *Keco Industries, Inc.* v. *United States,* 176 Ct. Cl. 983, 998–99, 364 F.2d 838, 847–48 (1966), *cert. denied,* 386 U.S. 958 (1967); *Aragona Construction Co.* v. *United States,* 165 Ct. Cl. 382, 390–91 (1964). In *Marden, supra,* we specifically stated that the purpose of the cardinal change doctrine is "to provide a breach remedy for contractors who are directed by the government to perform work which is not within the general scope of the contract." We have certainly never intimated, however, that the contractor is limited to a suit for extra costs incurred in performing duties fundamentally outside of the scope of the contract, and we have never held that the applicability of this doctrine is in any way dependent on the nature of damages sought by the contractor. Although the typical case, thus far, has featured a plaintiff who undertook to perform despite the alteration of contractual obligations, this does not preclude a suit by a contractor who, for one reason or another, has not completed the contract. Undoubtedly, the cautious contractor might often proceed under the revised contract because of doubt whether he could invoke the cardinal change doctrine. But if he has been prevented from performing, as in any breach case, the award of anticipatory profits is an appropriate remedy. *See Carchia* v. *United States,* 202 Ct. Cl. 723, 729, 485 F.2d 622, 625 (1973); *General Builders Supply Co.* v. *United States,* 187 Ct. Cl. 477, 485–86, 409 F.2d 246, 251 (1969); *J.D. Hedin Construction Co.* v. *United States,* 187 Ct. Cl. 45, 58–59, 408 F.2d 424, 431–32 (1969).

Conversely, it would seem at least moderately obvious that the failure to furnish property the government

promised to furnish would sometimes be remediable under the contract and therefore would not always be a breach. *Compare S.S. Mullen, Inc.* v. *United States*, 182 Ct. Cl. 1, 389 F.2d 390 (1968) *with Chris Berg, Inc.* v. *United States*, 182 Ct. Cl. 23, 389 F.2d 401 (1968).

Plaintiff also is of the opinion that cardinal change analysis is misapplied in this particular context. In support of this position, plaintiff notes that the standard changes clause in its contract is limited to variances in "drawings, designs, or specifications, where the supplies to be furnished are to be specially manufactured for the government in accordance therewith; method of shipment or packing; and place of delivery." The contract also contains a Government Furnished Property clause authorizing equitable adjustments for "any delay in delivery of government-furnished property; delivery of such property in a condition not suitable for its intended use; and any withdrawal of authority to use property." Plaintiff apparently reasons that the presence of a separate clause pertaining to the availability of the production facilities for use by Allied renders the cardinal changes doctrine inapplicable. There is no need to read the doctrine so restrictively as to hold that it applies only to deviations which are specifically within the conventional changes clause. The doctrine is couched in terms which apply generally to modifications which are so fundamental that they cannot be redressed within the contract by an equitable adjustment to the contract price, whether under the Government Furnished Property clause, the traditional changes clause, or any other. As we noted earlier, some variances in the availability of property contractually to be furnished by the government might well be remediable under the contract by an equitable adjustment.

In the order of September 30, 1977, it was stated that "[t]here may be sufficient foundation for our de novo jurisdiction in this case if plaintiff proves only a breach of contract, not remediable by change order." We might better have said, and now say, that plaintiff must show a breach not remediable by an equitable adjustment under the contract.

Plaintiff contends, secondly, that in any event the comprehensive record developed in the prior ASBCA proceedings conclusively demonstrates that the sale of the tooled equipment constituted a cardinal change. Thus, argues plaintiff, no additional trial is necessary on this point, and the case is ripe for summary judgment. Again, whether or not the ASBCA record is comprehensive, the Board did not engage in fact-finding specifically with regard to whether the sale of the government machinery constituted a cardinal change, as this issue was not raised by either party at the ASBCA level. Even when underlying facts are established, the drawing of conclusions as to ultimate facts is still a fact-finding function.

The existence of a cardinal change is principally a question of fact, requiring that each case be analyzed individually in light of the totality of circumstances. *See Wunderlich Contracting Co.* v. *United States*, 173 Ct. Cl. 180, 194, 351 F.2d 956, 966 (1965); *Saddler* v. *United States*, 152 Ct. Cl. 557, 561, 287 F.2d 411, 413 (1961). It may well be that plaintiff will be able to satisfy the burden of going forward with a prima facie case simply by offering the record from the ASBCA proceedings. Since the applicability of the cardinal change doctrine was not before the Board, however, defendant should be afforded the opportunity to present any relevant evidence to the trial judge before this matter is finally resolved.

Plaintiff has similarly criticized our order for directing a trial on the subject of defendant's bad faith, if any, in terminating the contract for convenience, on the ground that the comprehensive ASBCA record conclusively established defendant's bad faith. As we suggested in the order, the Board did not consider whether the termination for convenience was issued in bad faith, but rather directed its efforts toward the issue of defendant's bad faith in negotiating the termination settlement. Again, if plaintiff regards the Board record as sufficiently comprehensive, it has the option of resting on that record. Defendant is nevertheless entitled to an opportunity to present additional evidence on this point.

For the foregoing reasons, and a majority of judges on active service not having voted to rehear the case *en banc*,

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it is ordered that plaintiff's motion for a rehearing of its cross-motion for summary judgment is denied, and the case is remanded to the Trial Division for further proceedings in accordance with our order of September 30, 1977.

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570 F.2d 924

FRED HAGENY v. THE UNITED STATES

[No. 12–73. Decided January 25, 1978]

ON THE PROOFS

Contracts; tree cutting and removal contract; false claims; weight and sufficiency of evidence.—In November 1969, for a price of $31,426.30 payable to the Forest Service in increments applicable to each of four designated Payment Units, plaintiff was awarded a contract giving him the right to have crews (determined to be independent contractors) cut and remove designated trees, i.e. trees marked by Forest Service employees in two places with orange paint within the sale area in Nicolet National Forest. Payment to the crews was based on the amount of timber they cut and removed from the woods—more timber, more pay. Plaintiff did not supervise to any degree the logging operations. Upon completion of operations in Units 1 and 4, the Forest Ranger in charge (Keppen) before approving contract performance in each Unit, checked each area to insure that all marked trees were cut, and noted in a book details of any unmarked trees and any other irregularities. Units 1 and 4 were approved by Keppen. Approval only meant that Keppen had satisfied himself that operations were conducted properly and in reasonable accord with contract terms. In Unit 2, Keppen discovered wet orange paint on a cut tree and on two standing trees where two of the crew had been working; the paint was found to be non-Forest Service paint. The contract was suspended in January 1971, and after operations in Units 1, 4 and 2 were recruised, it was found that 52 stumps in the three Units bore non-Forest Service paint and that 226 unmarked trees had been cut and removed without contractual authorization. Under the contract, plaintiff agreed to pay double stumpage value for each undesignated tree cut and removed. Plaintiff seeks damages attributable to suspension of the contract. Defendant counterclaims for the stumpage value of the undesignated and removed cut trees, i.e $3,488.84, and, based on the False Claims Act, for forfeiture payments of $556,000 and double damages of $6,977.68. It is *held* (1) that defendant is entitled to recover $3,488.84 on its first counterclaim, since plaintiff contractually agreed to pay double stumpage value for each undesignated tree cut and removed because of the likelihood that mistakes might result in cutting and removal of

Syllabus

undesignated trees; (2) that, assuming, but not deciding, that plaintiff's conduct constitutes a "claim" within the meaning of the False Claims Act, defendant has failed to carry its burden of proving by clear and convincing evidence that plaintiff conspired to commit fraud, or practiced or attempted to practice fraud against the United States either in deliberately and intentionally cutting 226 unmarked trees or in directing, encouraging or abetting others in improperly painting and cutting 52 trees in an effort to defraud the United States of the value of the trees. Defendant is not entitled to recover on its second counterclaim and special plea in fraud. The petition is dismissed.

Fraud against the Government; False Claims Act—31 U.S.C. §231; generally.

[1] The False Claims Act was not designed to reach every kind of fraud practiced on the Government. The phrase "claim upon or against the Government of the United States" in the Act normally connotes a demand for money or for some transfer of public property which is presented for payment or approval to an officer of the United States.

United States ⚖120

Fraud against the United States; False Claims Act—31 U.S.C. § 231; evidence of fraud.

[2] The degree of proof necessary to establish fraud demands more than a preponderance of the evidence. Defendant has the burden of proving by clear and convincing evidence that plaintiff's conduct constituted fraud against the Government within the purview of the False Claims Act. In the present case respecting the 226 unmarked trees, assuming, *arguendo*, that the conduct of plaintiff constitutes a "claim" within the meaning of the Act, since the parties agreed on the manner in which the cutting, removal and billing of unmarked trees would be handled, and absent evidence that plaintiff or his crews deliberately and intentionally cut and removed said trees, there is no basis for a finding of fraud because unmarked trees were, in fact, cut and removed. The fact that plaintiff did not pay for the unmarked trees when billed by the Government neither adds to nor detracts from the question of whether plaintiff committed fraud against the Government.

United States ⚖120

Evidence; presumptions; failure to call witness.

[3] Inconsistent, conflicting and hazy testimony by a Government witness, together with the failure of the Government to call a witness listed in its pretrial submission and who was cognizant of the circumstances of the painting of the trees, and the failure of the Government to explain why it did not call the proposed witness, gives rise to an inference that the latter's testimony would be unfavorable to defendant.

Evidence ⚖77(1)

Fraud against the United States; False Claims Act—31 U.S.C. §231; evidence of fraud.

[4] Where the record evidence shows that crews utilized by plaintiff were independent contractors and that plaintiff did not exercise control

over them, and where the Government has failed to submit clear and convincing evidence that plaintiff had caused the unauthorized tree cutting, removal and painting activities, defendant's contention that because plaintiff was the primary beneficiary improper activities of the logging crews should be imputed to plaintiff is without merit.

United States ⚖120

Evidence; weight and sufficiency of evidence; generally.

[5] Suspicion and speculation do not rise to the level of clear and convincing evidence.

Evidence ⚖596(1)

Fraud; evidence of fraud.

[6] A finding of fraud must rest on something more substantial than suspicion or speculation. Even a hint of fraud will not support a finding of fraud, nor will the existence of fraud be presumed.

Fraud ⚖50, 58(1)

Earl A. Charlton, attorney of record, for plaintiff. *Charlton, Gronowski, Welcenbach & Stanich,* of counsel.

Ray Goddard, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before COWEN, *Senior Judge,* NICHOLS and BENNETT, *Judges.*

PER CURIAM: This case comes before the court on defendant's exceptions to the recommended decision of Trial Judge Thomas J. Lydon, filed March 14, 1977, pursuant to Rule 134(h), having been submitted to the court on oral argument of counsel and the briefs of the parties. Upon consideration thereof, since the court agrees with the trial judge's recommended decision, as hereinafter set forth,* it hereby affirms and adopts the decision as the basis for its judgment in this case.** It is, therefore, concluded that defendant is entitled to recover on its first counterclaim the sum of $3,488.84 and judgment is entered for defendant against plaintiff in that amount. Defendant is not entitled to recover on its second counterclaim and special plea in fraud and they are hereby dismissed.

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* The concurring opinion of Judge NICHOLS follows the opinion of the trial judge which has been adopted by the court.

** Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed March 14, 1977, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

Further, implementing the court's judgment order of January 9, 1976, entered in this case, it is concluded that plaintiff is not entitled to recover on the claims asserted in his petition and the petition is hereby dismissed.

OPINION OF TRIAL JUDGE

LYDON, *Trial Judge:* Plaintiff, Fred Hageny, filed a petition in this court seeking to recover damages attributable to the suspension of a contract he had with the Forest Service, Department of Agriculture. Under this contract, plaintiff purchased the right to cut and remove some 1,390,500 board feet of timber from designated trees in the Eagle River Ranger District, Nicolet National Forest, Vilas County, Wisconsin. The suspension of plaintiff's right to continue work on the contract was based on his alleged "unauthorized tree marking" during the course of contract performance.

In its amended answer to the petition, defendant asserted two counterclaims and a special plea in fraud. Under its first counterclaim, defendant sought to recover $3,488.84, based on a provision in the contract, because of plaintiff's unauthorized cutting and removal of 278 trees during contract performance. This figure represented the double stumpage value of the 278 trees. Under its second counterclaim, defendant sought to recover $556,000 ($2,000 × 278 trees) and double damages of $6,977.68 ($3,488.84 × 2) on the authority of the False Claims Act, 31 U.S.C. §§ 231–35. In support of its second counterclaim, defendant alleged that "Fred Hageny and divers other persons, combined and conspired to defraud the Government of the United States by illegally marking and/or cutting and removing 278 trees and attempted to perpetrate 278 separate frauds and false claims knowing the same to be false, fictitious and fraudulent." In its special plea in fraud, defendant asked the court to declare the claims advanced by plaintiff in his petition as forfeited to the United States, pursuant to the provisions of 28 U.S.C. § 2514 because plaintiff "has practiced, or attempted to practice, fraud against the United States in the presentation * * * of its claims in its petition."

By order dated January 9, 1976, on a Rule To Show Cause, the court concluded, as a matter of law, that plaintiff was not entitled to recover on his petition. Defendant's two counterclaims were remanded to the trial judge for trial and subsequent findings of fact, conclusions of law, and opinion thereon. Dismissal of plaintiff's petition was deferred, pursuant to Rule 102(d), until final action was taken on the counterclaims. With the denial of recovery to plaintiff on the claims advanced in his petition, and the dismissal herein of said petition, defendant's special plea in fraud seeking forfeiture of said claims is rendered moot. Accordingly, defendant's special plea in fraud is no longer considered viable and is herein dismissed.

Consideration of defendant's first and second counterclaims has been largely a factual inquiry. Resolution of the questions presented by these counterclaims has been governed in large part by defendant's ability, or inability, to meet the burden of proof cast upon it by the nature of the counterclaims it pleaded. On the trial record, it has been concluded that defendant, by a preponderance of the evidence, met its burden of establishing a right to recover from plaintiff the sum of $3,488.84 under its first counterclaim. On the other hand, defendant has failed to meet its burden of establishing, by clear and convincing evidence, that plaintiff violated the False Claims Act, *supra*, so as to justify recovery under its second counterclaim. The reasons for these conclusions are hereinafter set forth in this opinion.

I

In 1969, and for some time prior thereto, plaintiff, operating in an individual capacity, had been in the business of logging timber.[1] He had logged timber under six different contracts with the Forest Service prior to November 1969. Four of these contracts were clear-cut timber sale contracts and the other two contracts were

[1] The facts are set out in exhaustive detail in the Findings Of Fact. Only a brief summary of those facts are set out hereinafter, sufficient, it is believed, to place the contentions of the parties in proper perspective.

selective-cut timber sale contracts. Under a clear-cut timber sale contract, a contractor purchases the right to cut and remove all the timber located within the sale area. Under a selective-cut timber sale contract, a contractor purchases the right to cut and remove only selected and designated timber within the sale area. On this record, it is concluded that plaintiff satisfactorily performed all timber sale contracts he had with the Forest Service prior to November 1969.

The Nicolet National Forest was managed and protected by the Forest Service, Department of Agriculture. The Forest itself was divided into Ranger Districts. Each District was supervised by a Forest Ranger. At all times material herein, Gary H. Keppen (Keppen) was the Forest Ranger in charge of the Eagle River Ranger District, which District was located in the northeast section of Wisconsin. Keppen's duties included, *inter alia*, the preparation of Information For Bids (IFB) relative to sale of Forest timber and the administration of timber sale contracts.

Sometime in 1968, an area of roughly 483 acres in the Eagle River Ranger District was designated by the Forest Service as the site for a prospective timber sale. This sale area was broken down into four Payment Units. The perimeter of the sale area and the perimeters of the Payment Units were identified by blue paint markings on perimeter trees. This timber sale was known to all concerned as the Kentuck Lake Sale. It was to be a selective-cut timber sale.

In order to obtain information necessary for the preparation of an IFB on the Kentuck Lake Sale, Keppen cruised the sale area. Thereafter, he took a crew of Forest Service employees into the sale area and marked those trees which were to be cut by the successful bidder. Appropriate data was taken relative to each marked tree which subsequently was translated into meaningful information on the IFB on which bidders would act. The trees selected to be cut and removed from the sale area were marked by the Forest Service crew with a special orange paint in two places, *i.e.*, at eye level (roughly diameter breast high (DBH)) and at the stump. This orange paint was manufactured especially for the Forest Service by the Nelson Paint Company, Iron

Mountain, Michigan, and was not available for sale to the general public. The paint contained certain tracer elements which would surface when the paint was subjected to analysis tests. Characteristically, this paint had a dull orange appearance. Use of this special orange paint enabled the Forest Service to verify whether or not trees marked for cutting and removal in the Nicolet National Forest had been properly marked by Forest Service personnel or improperly marked by other persons. The Forest Service had been plagued by improper tree marking in the Nicolet National Forest and use of this special orange paint was one attempt to combat this problem.

The IFB on the Kentuck Lake Sale produced two bids. Since plaintiff's bid was the high one, he was awarded a contract on November 25, 1969, wherein for a total price of $31,426.50 he was given the right to cut designated trees, *i.e.*, trees "marked with orange paint at DBH and on the stump" within the confines of the sale area.[2] Under the contract, plaintiff was to pay the Forest Service the purchase price applicable to each Payment Unit prior to cutting and removing the designated trees on said Unit. When all the designated trees were cut and removed from that Payment Unit and the logging work thereon was approved by the Forest Ranger, the next Payment Unit would become available to the contractor, and upon payment of the purchase price applicable thereto he would commence cutting and removing designated trees from this Payment Unit. The contract work sequence was as follows: Payment Unit No. 1 (Purchase Price—$10,727.50, comprising about 170 acres); Payment Unit No. 4 (Purchase Price—$4,428.00, comprising about 67 acres); Payment Unit No. 2 (Purchase Price—$9,411.50, comprising about 148 acres); Payment Unit No. 3 (Purchase Price—$6,859.50, comprising about 85 acres).

Around the first of July 1970, plaintiff paid the Forest Service the purchase price applicable to Payment Unit No. 1 and commenced logging in said area. After completing

[2] Under the contract, plaintiff also had the right to cut certain undesignated trees such as aspen and balsam fir trees. In general the designated trees were hardwood trees and it was estimated that the great majority of the timber sale trees were hardwood trees. The undesignated trees were primarily pulpwood trees.

logging activities in Payment Unit No. 1, plaintiff so advised Keppen. Keppen thereafter went about inspecting the logging operations in this Unit. Before giving his approval as to contract performance in this Unit, Keppen was alert to insure that all marked trees were cut; that any unmarked trees that were cut were recorded in a scale book Keppen maintained together with appropriate data which would enable determination at a later time of the value of said trees; and that any other irregularities in contract performance were noted for appropriate action. For example, before approving Payment Unit No. 1, Keppen required plaintiff to clean up logging slash in the Unit. Thereafter, plaintiff paid the purchase price applicable to Payment Unit No. 4 and logged that Unit. After Keppen approved the logging operations in Payment Unit No. 4, plaintiff paid the purchase price applicable to Payment Unit No. 2 and began logging operations in that Unit. Keppen conscientiously checked out Payment Unit Nos. 1 and 4 before approving the conduct of logging operations thereon. However, his approval in this regard only meant that he had satisfied himself that all logging activities were conducted properly and in reasonable accord with the terms of the contract. It did not mean he had inspected every stump and/or tree in the Units. It was in Payment Unit No. 2 that wet paint was discovered relative to logging operations, which discovery provided the foundation for this litigation.

As indicated earlier, plaintiff contracted in his individual capacity. In performing the Kentuck Lake Sale contract, plaintiff utilized the services of three crews. Each crew consisted of a cutter, *i.e.*, one who fells the tree and thereafter cuts the tree into logs, and a skidder, *i.e.*, one who operates a piece of machinery (called a skidder) which drags the logs from the woods to a road from which they can be transported to a lumber mill and/or buyer. Without elaboration, these crews can properly be considered independent contractors. The crews negotiated with plaintiff relative to the price of their services. These negotiations generally centered on the price per timber cord or thousand board feet (MBF) to be paid for timber cut and removed from the sale area. In essence, payment to them

was based on the amount of timber they cut and removed from the woods. The more timber the crews cut and removed, the more money the crews made. Plaintiff did not withhold any payments from these crews for purposes of unemployment compensation. Moreover, these crews, by and large, worked when they pleased and were practically unsupervised in their logging operations. On this record, it is reasonably clear that plaintiff did not supervise to any degree the logging operations taking place on the Kentuck Lake Sale.

On the morning of December 4, 1970, Keppen discovered wet paint on the stump of a cut tree as well as on two standing trees in Payment Unit No. 2 in an area where Neal Marvin, a cutter, and his cousin, Ronald Marvin, a skidder, were working. The trees were painted in the manner followed by the Forest Service, *i.e.*, at DBH and at the stump. There was a foot of recent snow on the ground, and, because of the absence of any other tracks in the area, it seemed reasonable to conclude that the Marvins, who were working in that area that morning, were responsible for the painting of those trees. However, the Marvins denied painting the trees when questioned by Keppen at that time.[3]

Keppen, on December 4, 1970, took paint samples from the wet paint on the stump and on one tree. These paint samples were analyzed by the Nelson Paint Company and found to be non-Forest Service paint. On December 11, 1970, Keppen took paint samples from eight more marked trees in the same area of Payment Unit No. 2. Analysis of these paint samples showed seven of the trees had been marked with Forest Service paint whereas one tree had been marked with non-Forest Service paint.

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[3] Keppen first met with plaintiff, after the December 4 incident, on December 11, 1970. At the time of this meeting, plaintiff had been told by the Marvins that they had, in fact, painted these trees. However, plaintiff did not tell Keppen about this revelation because he felt Keppen already knew it since the only persons in the area on the morning of December 4 were the Marvins, and it should have been obvious to anyone that the Marvins painted the trees. Further, plaintiff felt Keppen was out to pin the tree marking incident on him and thus he refused to cooperate in any way with Keppen by voluntarily supplying information. The record indicates clearly that the Marvins painted the trees in question on their own initiative.

Keppen decided to investigate plaintiff's logging operations in Payment Unit Nos. 1, 4 and 2 more thoroughly. However, deep snows precluded any such investigation. Keppen, therefore, decided to wait until spring and then perform a recruise of these Units, examining tree stumps and trees for evidence of improper timber logging operations by plaintiff.

Confirmation of the fact that non-Forest Service paint was being used to mark trees suggested the commission of a possible trespass on property of the United States. Accordingly, Keppen was required to prepare, and he did prepare, a Trespass Report dated January 8, 1971. By letter dated January 8, 1971, Keppen notified plaintiff that his contract was suspended "until further notice in writing by the Forest Supervisor * * * because of the unauthorized tree marking discovered on 12/4/70."[4] This letter was sent so that a complete investigation of plaintiff's logging operations of Payment Unit Nos. 4, 1 and 2, by way of a recruise, could be conducted.

In April 1971, Keppen and his Forest Service crew performed a thorough, controlled and reliable recruise of Payment Unit Nos. 4, 1 and 2. The recruise was conducted on the assumption that the results thereof might be subjected to the scrutiny of litigation. Further, all doubts about whether a stump or tree was improperly marked or whether a stump was marked at all were to be resolved in favor of plaintiff. All stumps in these Units were examined. Marked trees which had not been cut were also examined.[5]

[4] Plaintiff never did complete the contract. With the approval of the Forest Service, plaintiff's brother, Don Hageny, was allowed, after payment of the purchase price applicable to Payment Unit No. 3, to complete the contract by cutting and removing appropriate trees from said Payment Unit. It would appear from the record that plaintiff had no desire to complete the contract and the Forest Service had no thoughts of allowing him to do so. However, there is no correspondence subsequent to January 8, 1971, in the record of further dealings between plaintiff and the Forest Service, relative to plaintiff's future performance of the contract.

[5] The recruise results showed that 18 standing trees in Payment Unit No. 1 and 2 standing trees in Payment Unit No. 2 were marked with non-Forest Service paint. The record does not indicate whether any standing trees marked with Forest Service paint were discovered during the recruise. As to Payment Unit No. 1, there is no explanation why these 18 trees were not cut and removed or why these standing marked trees were not detected by Keppen when he approved logging operations in the Unit. The presence of these standing marked trees raises an unanswerable question of whether or not these trees were painted after plaintiff had completed logging operations in Payment Unit No. 1.

The recruise crew took paint samples from suspected paint on stumps and trees. In this endeavor, the judgment and discernment of the crew governed. In general, Forest Service paint, as indicated previously, had a dull orange color. Non-Forest Service paint, on the other hand, had a brighter orange color. These general facts controlled, for the most part, the crew's determinations of whether paint on a stump or on a tree was suspect so as to justify taking a sample thereof for analysis. While there was room for error in the recruise effort, the record justifies reliance on the recruise results as fairly and reasonably portraying the logging operations conducted on Payment Unit Nos. 4, 1 and 2.

Some 8,970 hardwood stumps were examined during the recruise effort. Two-hundred and nine (209) paint samples were taken from these stumps as well as from standing trees. Analysis by the Nelson Paint Company revealed that 52 stumps had been painted with non-Forest Service paint. This supported a conclusion that 52 trees had been improperly marked, cut and removed from Nicolet National Forest during the course of plaintiff's logging operations in Payment Unit Nos. 4, 1 and 2. The 52 improperly marked and cut trees were broken down as follows: 8 stumps in Payment Unit No. 4; 36 stumps in Payment Unit No. 1; and 8 stumps in Payment Unit No. 2.

Examination of the 8,970 stumps during the recruise established that 226 stumps had not been painted (marked) at all and justified the conclusion that these 226 unmarked trees were cut and removed from the Nicolet National Forest without contractual authorization during the course of plaintiff's logging operations in Payment Unit Nos. 4, 1 and 2. As to these 226 stumps, 36 stumps were located in Payment Unit No. 4; 105 stumps in Payment Unit No. 1; and 85 stumps in Payment Unit No. 2.

The record preponderates in favor of a finding that plaintiff, operating through 3 two-man crews, cut and removed from Payment Unit Nos. 4, 1 and 2 some 278 trees which were not designated for cutting and removal by the contract which he had with the Forest Service. The stumpage value of these 278 trees was determined to be $1,744.42. The 226 unmarked trees which were cut and

removed had a stumpage value of $1,438.22. The 52 improperly marked trees had a stumpage value of $302.20. The record justifies a finding that the Forest Service stumpage value determinations as to these 278 trees were reliable and fair.

Under the contract, plaintiff agreed to pay double stumpage value for each undesignated tree he cut and removed from Nicolet National Forest during his logging operations. The double stumpage value of the 278 trees referred to above was $3,488.84 ($1,744.42 × 2). Although the Forest Service billed plaintiff for the double stumpage value of the 278 undesignated trees he cut and removed from the Forest, plaintiff has so far failed to pay for these trees.

II

The record in this case supports recovery by defendant on its first counterclaim in the sum of $3,488.84. The contract clearly provided that for each undesignated tree cut and removed from the Kentuck Lake Sale area, plaintiff would pay the Forest Service the double stumpage value of each such tree (contract provision BT3.23). Plaintiff was fully conversant with the language, operation and reach of this contract provision. Further, the cutting and removal of undesignated trees were the subject of discussion between plaintiff and Keppen. Both men agreed on how undesignated trees cut and removed from the sale area would be handled, *i.e.*, the Forest Service would bill plaintiff at the end of the contract for each undesignated tree cut and removed at the double stumpage value of said tree. There is no dispute over the interpretation and operation of the contract provision in question. The question to be resolved is whether plaintiff did in fact cut and remove 278 undesignated trees from the sale area.

The recruise effort established with a degree of reliability that 278 undesignated trees were cut in the sale area. The record preponderates in favor of a finding that these 278 trees were removed from the sale area by the logging crews engaged by plaintiff.[6] Under the contract provision,

[6] Plaintiff concedes that he should pay for undesignated trees cut and removed

agreed to by the parties, covering the cutting and removal of undesignated trees, plaintiff was required to pay the double stumpage value of these 278 trees.

The double stumpage value determinations by the Forest Service of the 278 trees in question were not seriously challenged by plaintiff. The record indicates these value determinations were arrived at in a fair, reasonable and objective manner. The double stumpage value of the 278 trees is found to be $3,488.84. Defendant is therefore entitled to recover that amount.

III

A

Defendant's second counterclaim, based on the False Claims Act, 31 U.S.C. §§ 231–35 (1970), seeks to recover from plaintiff forfeiture payments of $556,000 (278 trees × $2,000) and double damages of $6,977.68 ($3,488.84 × 2). Section 231 of the False Claims Act provides in pertinent part as follows:

> Any person * * * who shall make or cause to be made, or present or cause to be presented, for payment or approval [to an officer of the United States], any claim upon or against the Government of the United States, or any department or officer thereof, knowing such claim to be false, fictitious or fraudulent, or who, for the purpose of obtaining or aiding to obtain the payment or approval of such claim, makes, uses, or causes to be made or used, any false bill, receipt, voucher, roll, account, claim, certificate, affidavit, or deposition, knowing the same to contain any fraudulent or fictitious statement or entry, or who enters into any agreement, combination or conspiracy to defraud the Government of the United States, or any department or officer thereof, by obtaining or aiding to obtain the payment or allowance of any false

from the sale area. However, he claims that many trees were stolen from him and thus it would be unfair to assess him double stumpage value for trees which he never received. There is no reliable evidence in the record as to theft of trees from the sale area. Accordingly, there is no basis for such a contention. Plaintiff further claims that as to the 226 unmarked trees, it was possible for the weather and/or logging operations to obliterate a paint mark and thus possible for some of these 226 trees to have been properly marked at the time of cutting. The odds favoring this possibility were greatly reduced, if not eliminated, by the careful manner in which the recruise was conducted and the rationale underscoring the recruise effort of resolving all doubts in favor of plaintiff as to whether a tree had been marked or not.

or fraudulent claim, * * * shall forfeit and pay to the United States the sum of $2,000, and, in addition, double the amount of damages which the United States may have sustained by reason of the doing or committing such act, together with the costs of suit; and such forfeiture and damages shall be sued for in the same suit. [*See Miller* v. *United States*, 213 Ct. Cl. 59, 61–62, 550 F.2d 17, 18–19 (1977) for the official text of the Act as set out in the Revised Statutes.]

Defendant seeks to give the False Claims Act provision, *supra*, a very broad application so as to embrace any type of fraudulent act, without qualification, that results in a monetary or property loss to the United States. It relies, in this regard, on its reading of *United States* v. *Bornstein*, 423 U.S. 303 (1976); *United States* v. *Neifert-White Co.*, 390 U.S. 228 (1968) and a number of other District Court and Court of Appeal decisions. However, it is clear that the False Claims Act was not designed to reach every kind of fraud practiced on the government. *United States* v. *McNinch*, 356 U.S. 595, 599 (1958); *see also United States* v. *Marple Community Record, Inc.*, 335 F.Supp. 95, 99–100 (E.D. Penn. 1971); *Cahill* v. *Curtiss-Wright Corp.*, 57 F.Supp. 614, 616 (W.D. Ky. 1944).

The above observation raises a question that must be considered initially in this case, *i.e.*, whether the conduct of plaintiff on which defendant relies constitutes a claim, or claims, within the purview of the False Claims Act. Plaintiff has not addressed himself to this question and one might accordingly assume that he considers the alleged conduct to fall within the ambit of the Act. Since plaintiff did not confront this question, defendant's brief has met the substance of this question with broad generalizations supported by statements it has found in the various False Claims Act decisions it has cited. These supporting statements must be read in the context of the factual circumstances in which they were rendered. In every case relied on by defendant the conduct complained of included the submission in one form or another of an alleged fraudulent document, considered to be a claim, upon which governmental action was sought.[7] It has been observed that

[7] *See*, for example, *United States* v. *Bornstein*, 423 U.S. 303 (1976), *United States* v.

the phrase "claim upon or against the Government of the United States" in the False Claims Act normally connotes a demand for money or for some transfer of public property which is presented for payment or approval to an officer of the United States, *United States* v. *McNinch, supra,* 356 U.S. at 599. *See also United States* v. *Tieger,* 234 F.2d 589, 590–92 (3d Cir. 1956). *United States* v. *Marple Community Record, Inc., supra,* 335 F.Supp. at 99.

It is clear in this case that plaintiff did not submit in any form, written or otherwise, a "claim" seeking to recover money or property from the government. Defendant does not argue to the contrary. The conduct on which defendant relies, and on which it premises its False Claims Act counterclaim, involves the cutting and removal by plaintiff's logging crews of undesignated trees from the Nicolet National Forest. While the cutting and removal of these trees was not authorized by contract or otherwise, it was viewed as a trespass by the Forest Service, and indeed may have constituted a wrong doing against the government (*e.g.*, tort, or conversion, or deceit, or theft), no manifestation of the submission of a claim—formal or informal—preceded and/or accompanied and/or followed accomplishment of the act of cutting and removing said trees.

Defendant admits that claims within the purview of the False Claims Act are generally presented in some written form which seeks to recover money or property from the government. However, it argues that the Act should not be so restrictively or rigidly read. It maintains, in essence, that any fraudulent conduct involving loss of government property, whether manifested in some written form or by conduct without any written predicate, falls within the

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Cherokee Implement Co., 216 F.Supp. 374 (N.D. Iowa 1963) and *United States* v. *Gardner*, 73 F.Supp. 644 (N.D. Ala. 1947) [invoices]; *United States* v. *McNinch*, 356 U.S. 595 (1958), *cf. United States* v. *Neifert-White Co.*, 390 U.S. 228 (1968) [loan applications]; *United States ex rel. Marcus* v. *Hess*, 317 U.S. 537 (1943) and *Murray & Sorenson, Inc.* v. *United States*, 207 F.2d 119 (1st Cir. 1953) [contract bids]; *United States* v. *Cohn*, 270 U.S. 339 (1926); *United States* v. *Cooperative Grain & Supply Co.*, 476 F.2d, 47 (8th Cir. 1973) and *Alperstein* v. *United States*, 291 F.2d 455 (5th Cir. 1961) [various applications]; *United States* v. *National Wholesalers*, 236 F.2d 944 (9th Cir. 1956), *cert. denied*, 353 U.S. 930, and *Faulk* v. *United States*, 198 F.2d 169 (5th Cir. 1952) [labels]; *United States* v. *Collyer Insulated Wire Co.*, 94 F.Supp. 493 (D. R.I. 1950) [test reports and/or vouchers]. *See also Miller* v. *United States*, 213 Ct. Cl. 59, 550 F.2d 17 (1977). [consolidated billings].

ambit of the Act. Defendant would have the fraudulent conduct itself constitute the "claim" regardless of whether governmental approval of such conduct, in one form or another, was sought. Under this view, a simple theft of government property would constitute a "claim" within the ambit of the False Claims Act. However such a broad view of the term "claim" does not seem warranted by the legislative history of the False Claims Act or by case law. Indeed, the Supreme Court has cautioned that the words "claim against the Government" in the False Claims Act "must be carefully restricted, not only to their literal terms but to the evident purpose of Congress in using those terms, particularly where they are broad and susceptible to numerous definitions * * *." *United States* v. *McNinch, supra,* 356 U.S. at 598.

In support of its position, defendant, for example, relies on the following statement to be found in *United States* v. *Neifert-White Co., supra,* "* * * the Act was intended to reach all types of fraud, without qualification, that might result in financial loss to the Government. * * *" (390 U.S. at 232.)[8] However, this broad statement is tempered by the language in *United States* v. *McNinch, supra,* wherein the Supreme Court observed "* * * At the same time it is equally clear that the False Claims Act was not designed to reach every kind of fraud practiced on the Government. * * *" (356 U.S. at 599.)

In my opinion, a serious question exists as to whether the alleged conduct of plaintiff, relied on by defendant, constitutes a "claim" within the purview of the False Claims Act. However, under the circumstances of this case, resolution of such a question can be, and therefore should be, pretermitted. This action is deemed warranted because

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[8] The language in the *Neifert-White* Co. case must be read in the context of the issue in that case. The question in that case was whether a "claim" (loan application to Commodity Credit Corporation), within the meaning of the False Claims Act, must be read in a narrow sense so as to embrace only claims or demands for favorable action by the government on loan applications for payments due and owing from the government. The Supreme Court rejected such a narrow reading of the term "claim" and held it covered any claim or demand for favorable action by the government upon a loan application regardless of whether existing payments were due and owing from the government. It was in this context that the language relied on by defendant was utilized.

plaintiff has not challenged the application of the False Claims Act to the conduct in question, and more importantly, the matter has been fully tried on the merits and the decision reached herein on the merits serves to obviate the necessity for deciding the question. Accordingly, for purposes of decision herein, it has been assumed, but not decided, that the conduct of plaintiff upon which defendant relies constitutes a "claim" within the meaning of the False Claims Act.

B

The degree of proof necessary to establish fraud demands more than a preponderance of the evidence. *First National Steamship Co.* v. *United States*, 106 Ct. Cl. 601, 621–22 (1946). Indeed, it is clearly established that defendant has the burden of proving by "clear and convincing" evidence that plaintiff's conduct constituted fraud against the government within the purview of the False Claims Act. *Law* v. *United States*, 195 Ct. Cl. 370, 440–41 (1971); *Eastern School* v. *United States*, 180 Ct. Cl. 676, 694, 381 F.2d 421, 432 (1967). Defendant's burden is such that the evidence of record must be so clear and convincing that the mind can rest with safety upon a finding that fraud has been established. *New York Market Gardeners' Ass'n* v. *United States*, 43 Ct. Cl. 114, 138 (1908). On this record, it is concluded defendant has failed to carry the heavy burden imposed on it in this regard.

Defendant's fraud claim against plaintiff rests on the charge that plaintiff and other persons combined and conspired to defraud the government by illegally marking and/or cutting and removing 278 trees from the Nicolet National Forest. As indicated earlier, 226 unmarked trees were cut and removed from the sale area, and 52 improperly painted (marked) trees were cut and removed from the sale area. While defendant directs its fraud charge at the 278 cut and removed trees, the facts require that the two categories of trees, *i.e.*, unmarked trees and improperly painted trees, be discussed separately.

As to the unmarked trees cut and removed, it is difficult to find the ingredients necessary to support a fraud charge.

To begin, the cutting of unmarked trees in the Nicolet National Forest during performance of a timber sale contract was not unusual. Logging operations sometimes required the cutting of unmarked trees. At other times accidents or mistakes resulted in the cutting of unmarked trees. Undoubtedly there were occasions when unmarked trees were deliberately cut for their timber content. More importantly, a provision of the contract between plaintiff and the Forest Service covered such occurrences.

Plaintiff and Keppen, the Forest Ranger, discussed the cutting of undesignated trees, and both agreed on how such occurrences were to be handled. It was agreed between plaintiff and Keppen, by contract and by conduct, that all unmarked (undesignated) trees cut and removed during contract performance by plaintiff would be paid for by plaintiff at the end of the contract at double stumpage value rates. Keppen maintained a scale book in which he noted data applicable to unmarked trees he discovered plaintiff's crews had cut and removed during the logging operations. The data he recorded in this scale book enabled the Forest Service to determine at a later date the stumpage value of said trees.

Keppen, after an inspection, approved contract performance in Payment Unit Nos. 1 and 4 knowing that unmarked trees had been cut and removed by plaintiff's logging crews, although he did not know at the time he approved logging operations in these two Units that 141 unmarked trees had been cut and removed.[9]

Keppen testified that if he had discovered, during the course of policing Payment Unit Nos. 1, 4 and 2, that some 226 unmarked trees had been cut and removed by plaintiff's logging crews he would handle them as outlined

[9] As to Payment Unit Nos. 1 and 4, Keppen testified he had recorded in his scale book data relative to some 12 unmarked cut and removed trees he discovered while policing contract performance in those Units. Keppen considered 11 of these trees to have been cut unintentionally and one tree to have been cut intentionally. Keppen's scale book was not made a part of the record in this case. It could be that a greater number of unmarked cut trees were recorded therein than Keppen's testimony, based on memory, reflected. It is not unreasonable to conclude from the record that greater scrutiny by Keppen of plaintiff's logging operations would have revealed a greater number of cut and removed unmarked trees. There is no evidence that plaintiff or his crews attempted to conceal by overt acts or otherwise the cutting and removing of the 226 unmarked trees in issue.

above.[10] Keppen testified that if wet paint had not been discovered on trees in Payment Unit No. 2, he did not believe there would be any issue as to the 226 unmarked trees cut and removed—he would merely bill plaintiff at the end of the job for the value of the 226 trees at double stumpage rates. His testimony in this regard militates against any finding of fraud as to the cutting and removal of the 226 unmarked trees.

There is absolutely no evidence in the record relative to an agreement or conspiracy on the part of plaintiff and his crews to deliberately cut and remove unmarked trees from the sale area. Defendant has not established that there was a scheme or a plan or an effort to defraud the government by cutting and removing unmarked trees from the sale area. Plaintiff agreed to pay for each and every unmarked tree the logging crews cut and removed and the Forest Service agreed to bill him for each and every unmarked tree cut and removed.[11] Since the parties agreed on the manner in which the cutting and removal of unmarked trees would be handled, there is no basis for a finding of fraud because unmarked trees were, in fact, cut and removed. Evidence of fraud must be clear and convincing, *Klein* v. *United States*, 152 Ct. Cl. 8, 23, 285 F.2d 778, 786 (1961). Here, there is no evidence of fraud relative to the 226 unmarked trees which were cut and removed from the sale area.

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[10] He also testified he would have exercised greater scrutiny in his policing activities had he known that a large number of unmarked trees were being cut and removed. Moreover, he operated on the general assumption that unmarked trees were cut unintentionally. If he believed unmarked trees were being deliberately cut, he would take the matter up with the contractor. There is absolutely no evidence in the record that each of the 226 trees was deliberately cut and removed by plaintiff. Plaintiff testified that he did not intentionally cut unmarked trees. As to the one unmarked tree that Keppen felt was intentionally cut there is testimony in the record that it was unintentionally cut to free a felled tree that had lodged itself in the unmarked tree. On this record, defendant has failed to carry its burden of proving that plaintiff or his crews deliberately and intentionally cut and removed 226 trees from the Nicolet National Forest.

[11] The fact that plaintiff did not pay for the 226 unmarked trees when billed by the Forest Service neither adds to nor detracts from the question of whether plaintiff committed fraud against the government in cutting and removing these trees. By awarding defendant a judgment on its first counterclaim, the court has, in effect, required plaintiff to live up to its contractual agreement and pay the bill submitted by the Forest Service for the cutting and removal of those trees.

The record is barren of any meaningful evidence relative to the cutting and removal of the 226 unmarked trees. The conduct of plaintiff on which defendant relies in support of its fraud charge does not involve the 226 unmarked trees cut and removed from the sale area. Instead, this conduct centers on the 52 trees improperly painted with non-Forest Service paint which were cut and removed from the sale area. Defendant merely lumps the 226 unmarked trees which were cut and removed with the 52 improperly painted trees which were cut and removed and applies the fraud charge indiscriminately to both categories of trees. As indicated above, a finding of fraud as to the cutting and removal of 226 unmarked trees cannot be made on this record. Attention must now turn to the conduct relied on by defendant to support its fraud claim as to the 52 improperly painted trees.

Defendant maintains that plaintiff engaged in a fraudulent scheme to defraud the government by improperly painting (marking) and thereafter cutting and removing some 52 trees from the sale area. In support of this charge, defendant relies on the following testimonial evidence.

Defendant produced James M. Johnson of Crandon, Wisconsin, as a witness. The substance of Johnson's testimony was that in the summer or early fall of 1970, he drove to a wooded area with plaintiff and Douglas James Champine for the purpose of painting trees. As noted earlier, plaintiff had been awarded the Kentuck Lake Sale contract on November 25, 1969, although he did not commence logging operations until July 1970. Johnson testified that he and Champine painted trees for a couple of hours. Johnson claimed he painted around 100 trees himself. Johnson testified that plaintiff did not paint any trees. Indeed, according to Johnson, plaintiff never spoke one word to Johnson during the entire episode. According to Johnson, plaintiff walked through the woods while he and Champine were painting trees and occasionally plaintiff would motion with his hand toward a tree, which action indicated to Johnson he wanted that tree painted. Johnson testified that Champine told him they were on the Kentuck Lake Sale area and that plaintiff had the contract to cut the trees in this area.

Plaintiff, in his testimony, denied that he was with Johnson while Johnson was painting trees. Johnson also admitted that Champine disagreed with his testimony that they were painting trees in the Kentuck Lake Sale area. As detailed in the findings of fact, Johnson's demeanor as a witness was not persuasive. His testimony was inconsistent at times, hazy at times, and lacking in substantive and significant detail on matters which, had it been otherwise, might have added credibility to his overall testimony. More importantly, Johnson's crucial testimony connecting the site of the painting of the trees to the Kentuck Lake Sale area was based, not on personal knowledge, but on what Champine told him.

The conflicting testimony of plaintiff and Johnson serves to bring Champine to center stage. Pursuant to a standard pretrial order issued in the case under Rule 111, defendant listed Champine as a proposed witness in its pretrial submission. Defendant, however, did not call Champine as a witness, nor did defendant explain why it failed to call him as a witness. Under such circumstances, defendant's failure to call Champine as a witness supports an inference that his testimony would be unfavorable to defendant. *Estate of Ridgely* v. *United States*, 180 Ct. Cl. 1220, 1231 n.5 (1967). Such an unfavorable inference corroborates Johnson's admission, noted *supra*, that Champine does not agree with his testimony as to the painting episode.

One other observation serves to cast doubt on the testimony of Johnson. The recruise results revealed that approximately 72 stumps and standing trees had been improperly painted in the sale area. Such results do not support Johnson's testimony as to the large number of trees he and Champine painted in the sale area.

The record relative to Johnson's testimony is conflicting. His testimony failed to engender a feeling of believability. It certainly failed to establish clearly and convincingly that plaintiff conspired to defraud the government by illegally painting trees, or causing trees to be painted, in the Kentuck Lake Sale area.

Defendant produced Lawrence Jack Wilson as a witness. Wilson was a member of one of the three crews plaintiff engaged to cut and remove trees from the sale area. Each

crew consisted of a cutter, one who fells the tree and thereafter cuts the tree into logs, and a skidder operator. Wilson was a skidder operator, *i.e.*, he operated a machine, called a skidder, which dragged logs from the woods. Wilson's cutter at times material herein was Seldon Lykins. The substance of Wilson's testimony was that at some time while he was working in the sale area, plaintiff drove up in an automobile with his brother Tom Hageny in the passenger's seat. Tom Hageny got out of the car, took a quart can of orange paint from the front floor passenger side of the automobile and told Wilson to paint (mark) some of the nicer trees. Wilson agreed to do so. Plaintiff did not get out of the car, nor did plaintiff, according to Wilson, say anything to Wilson. Wilson offered no testimony as to whether plaintiff actually heard Tom Hageny's conversation with him. Wilson testified he painted a lot of timber in the sale area. He claimed he made no effort to conceal his tree painting activities from his cutter, Seldon Lykins, and he assumed Lykins knew he was painting trees.

Wilson's testimony was devoid of any time frame or sale area location relative to the Tom Hageny incident and his subsequent painting activities. The findings of fact detail some of the problems created by Wilson's lack of testimonial preciseness in this regard. Wilson admitted he never had any conversations with plaintiff about painting trees. Indeed, he admitted plaintiff never told him to paint trees. He testified that plaintiff was not around much and that plaintiff never saw him painting trees and he never told plaintiff he was painting trees.

Plaintiff, in his testimony, denied that he was present at the time Wilson claims Tom Hageny gave him the quart of orange paint.

Wilson's testimony was not persuasive. His account of critical events, as indicated earlier, was lacking in reliable specificity as to time and place. Moreover, his account of painting a lot of timber does not comport in any reasonable way with the recruise results, a fact noted, *supra*, relative to Johnson's testimony. Further, there was no corroboration of Wilson's testimony in the record.

It seems reasonable to assume, as Wilson did, that Lykins would have known of Wilson's tree painting

activity. As was the case with Champine, defendant listed Lykins as a proposed witness in its pretrial submission pursuant to Rule 111. However, defendant did not call Lykins as a witness, nor did defendant explain its failure to call him as a witness. Under the circumstances, it is reasonable to infer that Lykins' testimony would be unfavorable to defendant. *Estate of Ridgely* v. *United States, supra.*[12]

Wilson's testimony, when viewed in the light of the entire record, fails to show clearly and convincingly that plaintiff conspired to defraud the government by improperly painting trees, or causing trees to be painted, in the sale area. At best, it merely shows that Wilson may have painted trees in the sale area on his own initiative.

Defendant also produced as witnesses Neal Marvin and his cousin Ronald Marvin. The Marvins were one of the three crews which logged the timber for plaintiff on the Kentuck Lake Sale. Neal Marvin was a cutter and Ronald Marvin was a skidder. The Marvins were the ones who were caught painting trees in Payment Unit No. 2 on December 4, 1970 by Keppen. Defendant maintains that the testimony of the Marvins corroborates its contention that plaintiff masterminded a tree-stealing scheme to defraud the Forest Service. The record does not support such an assertion.

The Marvins admitted to painting trees in the Kentuck Lake Sale area during contract performance. Parenthetically, they had denied painting trees when confronted by Keppen on December 4, 1970, and thereafter. Their testimony was conflicting as to the number of trees they painted. Neal Marvin claimed he only painted some 10 to 12 trees at one point, and yet, at another point, claimed he painted some 50 trees. Neal Marvin claimed he never painted and cut a tree unless the tree was damaged by logging operations or was in the path of a skidder.[13]

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[12] Neither party listed Tom Hageny as a witness in the pretrial submissions each made pursuant to Rule 111. The record does not indicate whether he was available for testimonial purposes, nor does the record provide any explanation why he was not called by either party as a witness. Under the circumstances, no inference will be drawn one way or another relative to his absence as a witness. *See McClure* v. *United States,* 98 Ct. Cl. 381, 388 (1943).

[13] He claimed he took to painting trees because Keppen caught him cutting up an

The record supports a finding that the Marvins painted and cut trees in the sale area on their own initiative.[14] The Marvins testified that neither plaintiff nor Tom Hageny ever told them, or asked them, or suggested to them, that they paint trees for cutting purposes in the sale area. The Marvins testified that neither plaintiff nor Tom Hageny ever gave them paint. Further, the Marvins did not believe that either plaintiff or Tom Hageny were ever in the woods when they painted trees. Contrary to the contention advanced by defendant, the testimony of the Marvins suggests that plaintiff was not involved in any tree painting that took place in the sale area.[15]

In his testimony, plaintiff stated that he never saw anyone painting trees in the sale area; that he never gave any paint to anyone for purposes of painting trees in the sale area; that he never told anyone to paint trees in the sale area; and that he never authorized anyone to paint trees in the sale area.

Plaintiff testified that it was common knowledge that loggers were painting and cutting trees in the Nicolet National Forest. Keppen verified this fact in his testimony. Plaintiff testified that he wondered whether the crews he engaged painted and cut trees in the sale area during the

unmarked tree which he felt had to be cut because a properly marked tree fell, when cut, so as to become lodged in the unmarked tree (see n. 10, *supra*). Because Keppen upbraided him for cutting this unmarked tree, he decided to paint (mark) damaged or in-the-way trees in the future before cutting them and thereby, hopefully, avoid the wrath of Keppen. Neal Marvin was adamant in his testimony that he only painted, for cutting, damaged trees or trees in the skidder's way.

[14] It is perhaps necessary to mention again that the crews utilized by plaintiff are best characterized as independent contractors. Plaintiff did not feel he had any control over the crews while they were in the woods. They negotiated with plaintiff relative to the price at which they would agree to cut and haul timber from the woods. This price was based on the number of board feet of timber logged by the crews. As a result, the more timber the crews cut and hauled from the woods, the more money the crews would make. Of course, it also meant more money to plaintiff when he sold the timber. However, the fact that each crew benefited from the volume of timber cut and removed from the sale area serves to discredit defendant's contention that plaintiff was the primary beneficiary of unauthorized tree cutting and removal. Under the circumstances of this case, it would not be reasonable to impute the improper tree painting activities of the logging crews to plaintiff. *Cf. Wagner Iron Works* v. *United States*, 146 Ct. Cl. 334, 337–39, 174 F. Supp. 956, 958–59 (1959).

[15] The Marvins were not viewed as impressive witnesses. There were some inconsistencies in their testimony, and their initial denial of any involvement in tree painting in the sale area served to reduce their overall credibility rating.

course of the logging operations. However, he testified that he never knew this to be a fact until Keppen discovered wet paint on trees in Payment Unit No. 2 on December 4, 1970. *See Eastern School* v. *United States, supra,* 180 Ct. Cl. at 695–96, 381 F.2d at 432–34.[16] Plaintiff further testified that he had no control over the logging activities of the crews he engaged. He felt he could not run them off the job, even if he caught them painting trees, because of fear of reprisals against him.[17] However, he believed the Forest Service could handle the problem by barring from the woods those loggers who engaged in illegal tree painting.[18]

The testimonial evidence relied on by defendant to support its charge that plaintiff was part of a conspiracy and/or scheme to defraud the government of its property was conflicting, confusing, and lacking in probative reliability. *See W. H. Harrison Co.* v. *United States,* 101 Ct. Cl. 413, 418–20 (1944). Under no reading of the record in this case can this testimonial evidence be considered clear and convincing evidence that plaintiff practiced, or attempted to practice, fraud against the United States in the performance of his timber sale contract with the Forest Service. Defendant has failed to meet the heavy evidentiary burden cast upon it relative to the fraud charge it has pleaded in this case. *See Law* v. *United States, supra,* 195

[16] Plaintiff's testimony revealed that he was fully acquainted with the "tricks" of the logging trade. His demeanor and testimony generated a suspicion on the part of the trier of fact that he knew what was going on in the woods, *i.e.,* that tree painting was going on to some degree in the sale area. This suspicion does not embrace speculation that he therefore must have ordered, directed, controlled, or encouraged tree painting in the sale area. Suspicion and speculation, however, do not rise to the level of clear and convincing evidence. A finding of fraud must rest on something more substantial than suspicion or speculation. *See Dubois Constr. Corp.* v. *United States,* 120 Ct. Cl. 139, 175, 98 F. Supp. 590, 597 (1951); *Terrill* v. *United States,* 35 Ct. Cl. 218, 222 (1900). Indeed, even a hint of fraud will not support a finding of fraud, *see Eastern School* v. *United States, supra,* 180 Ct. Cl. at 698, 381 F.2d at 434, nor will the existence of fraud be presumed. *DeLuca* v. *United States,* 69 Ct. Cl. 262, 264, *cert. denied,* 282 U.S. 862 (1930).

[17] On December 13, 1970, two of plaintiff's skidder machines were burned in the sale area not far from where the wet paint was discovered on December 4, 1970. Plaintiff pointed to this occurrence as an example of the form a reprisal could take.

[18] Plaintiff was quite upset with the fact that although the Marvins had been caught painting trees in the sale area, Keppen, while prohibiting them from working in that area of Payment Unit No. 2 where the wet paint incident on December 4, 1970, took place, did allow the Marvins to continue logging timber in other parts of the sale area after said incident.

Ct. Cl. at 440–42, 445–49, 453; *Eastern School* v. *United States, supra,* 180 Ct. Cl. at 694–98, 381 F.2d at 431–34. Defendant's second counterclaim must be dismissed.

NICHOLS, *Judge,* concurring:

I concur in the result. I agree as to defendant's first counterclaim. As to the second, I think the court should have adopted the trial judge's analysis of the False Claims Act in part III A of his opinion, except for the last three sentences thereof. These I would strike, and substitute a flat statement that plaintiff's acts as asserted by defendant did not constitute false claims under the statute, 31 U.S.C. §§ 231–235. This would render the discussion in part III B moot.

As to the removal of 226 unmarked trees, this, if wrongful, was simple larceny. Plaintiff misused his right to go into the forest for the marked trees, to steal others he found there. No false assertion was made by word or act. As regards the 52 falsely marked trees, analysis in more depth is required, but essentially larcenous conduct is likewise revealed. False marking may be the basis of a False Claims Act assessment, as it was in *United States* v. *Bornstein,* 423 U.S. 303 (1976), where the false markings supported false invoices. If the false markings in this case had been devised to deceive Government inspectors in checking out the logs, before plaintiff was allowed to remove them from the forest, there might be a different and closer case. Here, however, their use was only to deceive the forest rangers making a post audit of the stumps after the cutting was over. This is comparable to a jewel thief leaving a paste gem behind so that his theft of a real one will not be so soon discovered. It is still larceny.

The *Bornstein* opinion, in characteristic present day style, has its most important statement, for our purpose at least, in a footnote. This is footnote 8, at 313, reading:

> This Court has noted that in construing § 5438 [of the Revised Statutes] "we are actually construing the provisions of a criminal statute. Such provisions must be carefully restricted, not only to their literal terms but to the evident purpose of Congress in using those terms,

> particularly where they are broad and susceptible [of] numerous definitions." *United States* v. *McNinch*, 356 U.S., at 598. See also *Rainwater* v. *United States*, 356 U.S. 590, 592–593.

It is explained earlier and in the references that the original statute was split up by the codifiers into civil and criminal sections, now entirely separate, but having been originally one. The definitions of the penalized acts must receive the strict construction of a criminal statute. An alleged offense, to generate a penalty, must pass both halves of a dual test. It must meet the literal language, *and* it must conform to the purpose judges suppose the Congress had in mind. The alleged liability of Mr. Hageny utterly fails to satisfy either part of this standard, or standards.

The defendant apparently would have us hold that the above analysis is superseded by the dictum in *United States* v. *Neifert-White Co.*, 390 U.S. 228, 232 (1968) "that the Act was intended to reach all types of fraud, without qualification, that might result in financial loss to the Government." This statement one might say cannot be of the highest authority, because it is not in a footnote, but in any case the later footnote in *Bornstein* shows it cannot have been intended to overrule prior authority in the premises, or if it was, it is now overruled in its turn.

In *United States* v. *McNinch*, 356 U.S. 595, 599 (1958), the Court of Appeals for the Third Circuit is quoted with approval as saying

> [T]he concept of a claim against the government normally connotes a demand for money or for some transfer of public property.

Mere larceny does not meet that standard, whether or not associated with an effort to disguise the theft or defer its discovery by false marking. It does not meet the literal language, nor does it come within the legislative purpose so far as the record as to that has come down to our time.

I am uncomfortable with the trial judge's analysis of the facts in his part III B. I am compelled to admit that our Rule 147(b) has a special application to a case such as this, where the credibility of witnesses is so large a factor. Moreover, the "clear and convincing evidence" rule, that was rightly applied, imposes on the defendant, which seeks

to assess the penalties, more than the ordinary burden of proof. Indeed, when our trier of fact has rejected the proof that a penalty has been incurred, as insufficient, to reverse him would be almost tantamount to reversing an acquittal by a jury in a criminal case, which we all know cannot be done. And we are construing what is virtually a criminal statute here.

I think the trial judge has failed to give proper weight to the rule that demonstrated false statements by an accused, when his conduct is questioned, are to be taken as evidence of a consciousness of guilt. *United States* v. *Strickland*, 509 F.2d 273 (5th Cir. 1975, op. by Nichols, J., sitting by designation), and cases cited.

In Finding 15(d) (adopted but not printed by the court), I read:

> At the meeting on December 11, plaintiff was aware that the Marvins had painted the three trees in question because the Marvins had told him they had done so. However, plaintiff did not tell Keppen this fact at any time. Instead, plaintiff told Keppen that the trees were painted by someone out to get him. Indeed plaintiff advised Keppen he (Keppen) could have painted the trees. * * *

Keppen was the forest ranger who first discovered the false painting of the trees. The trial judge also found that plaintiff lied about tree marking procedure in Finding 19(b). In Finding 19(g) the trial judge found that plaintiff testified that no complaints were ever made against him respecting his logging operations, whereas the record showed the Wisconsin State Division of Forestry and Recreation had made such a complaint and had debarred him from bidding on future sales of timber from state forests.

I would have been comfortable with a finding that whatever otherwise was deficient in defendant's proofs was supplied by these evidences of consciousness of guilt.

The trial judge in my view greatly overemphasizes the inferences to be drawn from the fact that defendant failed to offer the testimony of two witnesses it said at pre-trial it would produce. It may be a legitimate inference that, if put on the stand, their testimony would have been adverse to

defendant, but it is not legitimate to infer that such testimony would have been true. The case cited, *Estate of Ridgely* v. *United States*, 180 Ct. Cl. 1220 (1967), is a decision by Trial Judge Maletz (now of the U.S. Customs Court) and I concurred in its adoption per curiam. The holding relied on is in a footnote, which, as always, may be supposed of higher authority than the text. The witnesses not produced, though promised, would have testified as to their expert opinion of the value of a parcel of real estate. It was a tax case. They were not, like the missing witnesses here, involved in the *res gestae*. Defendant was not required to produce witnesses not connected with it or under its control, and presumably hostile, whose testimony, if favorable to defendant, would have incriminated themselves. In general, a party represents to the court that the witnesses it calls will give veracious testimony which it cannot attack. The special exceptions to this rule includes chiefly those whom a party by force of circumstances must produce. The court can, at its discretion, treat such witnesses as hostile, allowing the party calling them to cross-examine them as if the adverse party had called them. Normally, a party need not call hostile witnesses, and if he does, he adopts them as his own.

Defendant accepts the finding of 278 misappropriated trees for the purposes of its first counterclaim, but attacks it under the second, solely for the purpose of sustaining its witnesses. The trial judge discredits them on the ground the total number of trees they claimed to have mismarked greatly exceeded the numbers found, only 52. Defendant explains this by saying that when making his count, the forest ranger did not know that the miscreants who mismarked the trees simulated old paint by mixing motor oil with it. This seems to me a sufficiently plausible explanation why more mismarked trees were not found, to avoid discredit to the witnesses. At any rate, we all know it is human nature to exaggerate our sins once we start confessing any of them. This exaggeration does not prove we are free of sin.

The entire set of circumstances convinces me that plaintiff was privy to the mismarking. He was the principal beneficiary of it. It is hardly believable that the cutter-

skidder crews would mismark without his knowledge, since he could readily discover, disown, and expose their misdeeds if not in complicity. He falsified when the forest ranger first tumbled to what was going on. I think the defendant made a much stronger case than the trial judge allows. On a preponderance of evidence test, I think defendant would have won its second counterclaim, supposing the statute covered the case it tried to prove. I have already explained the reasons, as things are, that possibly would cause me to suppress my disagreement with the trial judge, if I had to rule on the fact issues. But they are moot in view of my construction of the statute.

Further, I think defendant's counsel is entitled to this much acknowledgement of the strength of his case, in view of plaintiff's attack on him as conducting a witch hunt or vendetta. It is asserted against him as an offense, that he traveled up into the Wisconsin woods, looking for witnesses. As a taxpayer, I would hope all Government counsel were so zealous. But there are easier ways of winning a lawsuit, than to persuade rural characters to testify against a rural claimant.

Since I wrote the above and circulated it to my colleagues on the panel, my attention was invited, in a different context entirely, to the recommended decision of Trial Judge Schwartz, filed August 16, 1977, in *O'Brien Gear & Machine Co.* v. *United States*, No. 105–72, in which he holds the "claim," as he calls it, of the plaintiff for redetermination of its Renegotiation Act liability, to be forfeit for fraud in the prosecution under 28 U.S.C. § 2514. He gives a broad construction to the word "claim" as used in that statute, which, as he shows, has been part of the statutory framework of Court of Claims jurisdiction since 1863. He emphasizes that the "claim" is "a word of many meanings, to be determined in the context of the purpose of the statute in which it is found."

Since the plaintiff has noted its intent to except, and the case will come before a panel of this court at some future date, it would be inappropriate for me to express either agreement or disagreement with Trial Judge Schwartz, and I do not do so. But I deem it necessary to notice his opinion to this extent: I wish to make explicit what was only

implicit in my concurring opinion, as previously written, that the meaning of the word "claim" in the False Claims Act, 31 U.S.C. §§ 231–235, is made narrow by special considerations applicable to that statute and, so far as I am aware, no other in which the word is used. Therefore, I do not consider that my views about the False Claims Act commit me to any particular construction of any other Act or Regulation in which the word "claim" is used.

CONCLUSION OF LAW

Upon the findings of fact and the foregoing opinion, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that defendant is entitled to recover on its first counterclaim the sum of three thousand four hundred eighty-eight dollars and eighty-four cents ($3,488.84) and that defendant is not entitled to recover on its second counterclaim and special plea in fraud and said second counterclaim and special plea in fraud are herein dismissed. The court further concludes, implementing its judgment order of January 9, 1976, in this case, that plaintiff is not entitled to recover on the claims asserted in his petition and that said petition is herein dismissed.

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572 F.2d 727

ALABAMA RURAL FIRE INSURANCE COMPANY v. THE UNITED STATES

[No. 332–76. Decided February 22, 1978]

ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT AND PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT

Contracts; breach; rescission of contract award; contract to provide insurance on property held as security for Farmers Home Administration loans; rural rehabilitation corporations; scope of activities.—In 1933 a program was established for rehabilitation of rural and other areas affected by the depression. Under the Federal Emergency Relief Act, state governors could apply for relief funds from

Syllabus

the Federal Government, the funds to be granted to the states through their rural rehabilitation corporations on condition that they were applied for rural rehabilitation (rehab.) purposes in the particular state. Plaintiff's parent, the Alabama Rural Rehabilitation Corp. (ARRC), was formed in October 1934 to serve as an agency in carrying out rehab. activities in Alabama. Subsequently, the rehab. corporations were asked to and did assign their assets to the United States in trust upon condition that the funds be used only in a trust capacity in the respective state. Under the 1950 Rural Rehabilitation Corporation Trust Liquidation Act the Secretary of Agriculture was ordered to liquidate the trusts and was authorized to return the trust assets upon application to the state rural rehabilitation corporations, with the proviso that the assets and the income therefrom be used only for such of the rehab. purposes permissible under the corporate charters as the Secretary approved. In 1970, by agreement, the liquidated trust assets were returned and unliquidated assets were to be returned to ARRC for rehab. purposes. In 1971 ARRC established plaintiff-subsidiary to provide fire and casualty insurance to Alabama farm families denied coverage by regular commercial companies, using the assets returned to ARRC. In approving the subsidiary, the Farmers Home Administration (FmHA) emphasized that plaintiff's activities would be restricted to rural areas of Alabama and to said uncovered farm families. In October 1973 FmHA issued a nationwide request for proposals which solicited bids from insurance companies to provide insurance on properties (including single and multiple housing, business facilities, farms, etc.) held as security for FmHA loans. Plaintiff offered to provide such insurance for 14 states and, after discussions with the contracting officer, offered to provide insurance for 49 states and certain U.S. possessions. A contract was awarded plaintiff in February 1974. In June 1974 the contracting officer rescinded the notice of award, claiming that it was null and void since inception because plaintiff lacked authority to provide insurance outside Alabama, and in August 1974 the present suit was filed claiming breach of contract and seeking damages. It is *held* (1) that the evidence does not show that the Government approved plaintiff's contracting to provide insurance in states outside Alabama; (2) that Congress intended that the assets returned to the rehab. corporations were to be used only for the benefit of residents of the respective states and that any contract award contemplating a broader use of the assets was forbidden; (3) that the contract was illegal under the 1950 Act and under Federal Procurement Regulations; (4) that the contract was of no effect; and (5) that the rescission of the contract award did not give rise to a legal claim. Defendant's motion for summary judgment is granted, plaintiff's motion for partial summary judgment is denied, and the petition is dismissed.

Contracts; formation of contracts; Government contracts; validity of; failure to comply with statute or regulation.

[1] Ambiguities concerning the legality of contract awards are resolved in the contractor's favor, but a clear showing of illegality in an award precludes any contract from arising. Illegality may be proved with

Syllabus

reference to legislative history or agreements restricting a party's ability to contract.

United States ⚖68

Contracts; formation of contracts; illegal contracts; duty of court.

[2] This court is bound to strike down illegal contracts no matter how that illegality is proved.

United States ⚖68

Contracts; parties; Government approval of contracting party; scope of approval.

[3] The Government's approval of the creation of plaintiff cannot be considered endorsement of the expansion of activities into states other than Alabama, despite the inclusion in plaintiff's charter of boilerplate language authorizing a wide range of activities, for the Secretary of Agriculture's approval was for a limited purpose and the statute indicates that returned state rural rehabilitation assets were to be used only within the state.

United States ⚖53(7)

Property; rural rehabilitation projects; rural rehabilitation corporations; scope of activities.

[4] The purposes of the Rural Rehabilitation Corporation Trust Liquidation Act are served only when state rural rehabilitation corporations and their subsidiaries limit their conduct of business to the state of their incorporation. The legislative history concerning such corporations evidences a congressional determination, faithfully and consistently complied with by executive agencies, that such corporations were to operate solely for and the assets of the corporations were to be used only for the benefit of citizens of the respective state.

United States ⚖53(7)

Contracts; authority of Government agent; unauthorized act of agent; Government not bound by.

[5] The Government is not bound by the unauthorized acts of its agents, and plaintiff has the burden of showing that the acts upon which it relies were authorized. That the contracting officer was a delegatee of the Secretary's power to engage insurance providers for purposes of state rural rehabilitation projects does not mean that he was authorized to determine, in accordance with the terms of the liquidation agreement between the Government and plaintiff's parent corporation, whether providing insurance outside Alabama was a permissible activity for plaintiff.

United States ⚖53(7)

Christopher Sanger for plaintiff. *Stefan F. Tucker*, counsel of record. *Tucker, Flyer, Sanger, Reider & Lewis*, of counsel.

James F. Merow, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, KASHIWA, and BENNETT, *Judges*.

BENNETT, *Judge*, delivered the opinion of the court:

This case involving the recision of a contract award to plaintiff comes before the court on defendant's motion for summary judgment and plaintiff's cross-motion for partial summary judgment. At issue is the authority of the Farmers Home Administration and of plaintiff to enter into a contract whereby plaintiff would provide insurance in 49 states and one territory on property held as security for Farmers Home Administration loans.

On October 19, 1973, the Farmers Home Administration (FmHA) issued a request for proposals which solicited bids from the insurance industry throughout the United States for the provision of insurance on property held as security for FmHA loans. Four companies responded, among them plaintiff.

Plaintiff's response, dated November 20, 1973, offered to provide such insurance for 14 Southern States. Following telephone discussions regarding the area to be served, on January 14, 1974, plaintiff told FmHA that it would be willing to provide such insurance for 49 states and the Virgin Islands. Idaho and Puerto Rico (for which satisfactory proposals had been received by defendant from two other companies) were not included. On February 14, 1974, Nick Chiddo, a FmHA contracting officer, notified plaintiff by letter that its offer had been accepted and that contract No. 12–20–1–7 had been awarded to plaintiff, effective immediately. Execution of a formal contract document was left for later.

On May 5, 1974, the contracting officer sent a telegram to plaintiff, stating,

> UPON RECEIPT THIS TELEGRAM, YOU ARE INSTRUCTED TO CEASE INCURRING ANY EXPENSES UNDER CONTRACT 12–20–1–7 UNTIL FURTHER NOTICE. UNITED STATES GOVERNMENT WILL NOT BE RESPONSIBLE FOR ANY EXPENSES INCURRED IN

VIOLATION OF THIS INSTRUCTION. THIS IS NOT, REPEAT NOT, A TERMINATION NOTICE.

On June 11, 1974, the contracting officer rescinded the notice of award, claiming that it had been null and void since its inception because plaintiff lacked authority to enter into such a contract, contrary to plaintiff's representations. On August 12, 1976, plaintiff sued here, claiming breach of contract and asking damages of $50,000, plus interest and costs.

The Government moved for summary judgment, claiming the contract was invalid because its performance would require activities of plaintiff which were forbidden both by statute and by the terms of an agreement between plaintiff's parent corporation and the United States. Plaintiff cross-moved for partial summary judgment on the issue of liability, claiming the contract was valid and that defendant was liable to plaintiff for costs incurred by the latter in preparing to perform the contract. Evaluation of these opposing contentions requires a review of the history of congressional enactments, executive administration, and plaintiff's origins, to which matters we now turn.

I

The Federal Emergency Relief Act of 1933[1] established a program for the rehabilitation of rural and urban areas struggling to recover from the depression. Under that statute, State Governors could apply for relief funds from the Federal Emergency Relief Administration. Applications were required to provide assurances of adequate administrative supervision. The mechanism devised to administer programs for rural areas was the creation of rural rehabilitation corporations within states desiring funds under the statute. Forty-three such corporations were established in 1934–35 to receive and administer funds in a like number of states. The funds were granted to the states, through their rural rehabilitation corporations, without any provision for their return to the United States, and the principal condition placed upon them was that

[1] Ch. 30, 48 Stat. 55 (1933).

they be applied for rural rehabilitation purposes in the states to which they were granted.[2]

In accordance with the 1933 legislation, plaintiff's parent, the Alabama Rural Rehabilitation Corporation (ARRC), was established on October 12, 1934. Paragraph III of its charter defined its purpose as being,

> * * * to promote the development and betterment of communities, municipalities and counties in this State [Alabama] and for the promotion of other public purposes. * * *

Paragraph V of the same document begins, "This Corporation shall serve as an agency in carrying out rehabilitation activities of and/or for the State of Alabama."

In 1935 additional funds were appropriated for the rural rehabilitation program in the Emergency Relief Appropriation Act of 1935.[3] That Act lacked a provision, present in the 1933 Act and in two 1934 appropriation measures, allowing grants to the states, and in June 1935 the Comptroller General determined that funds made available under the 1935 Act could be expended only as a direct federal activity and not through the state rural rehabilitation corporations. Those corporations, therefore, were asked to assign their assets in trust to the United States, acting through the Administrator of the Resettlement Administration, to be used by the United States as trustee in carrying on the rural rehabilitation program in the various states.[4]

Most of the rural rehabilitation corporations, including ARRC, reached agreements with the United States for transfers in trust of their assets to the United States,[5] although some of the corporations did not make such agreements, and the United States never asserted federal ownership of their assets.[6] Those rural rehabilitation corporations which returned assets to the United States to be held in trust did so "upon the specific condition that

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[2] S. REP. No. 403, 81st Cong., 1st Sess. (1949), *reprinted in* 1950 U.S. CODE CONG. Serv. 2202.

[3] Ch. 48, 49 Stat. 115 (1935).

[4] *See* note 2, *supra.*

[5] ARRC's first trust agreement with defendant was agreed to on Mar. 16, 1937.

[6] *See* S. REP. No. 403, *supra* note 2, at 2204.

they [the assets] be used only in a trust capacity in the appropriate States * * *."[7] The United States used various delegatees of the Secretary of Agriculture as trustees for the assets, that role being played by the Farmers Home Administration as of the time of the key legislation here.

The Rural Rehabilitation Corporation Trust Liquidation Act became law on May 3, 1950.[8] That Act, to the extent pertinent here, ordered the Secretary of Agriculture to liquidate trusts under the transfer agreements with the rural rehabilitation corporations of the several states and instructed him to convert the trust assets to cash as necessary to protect the interests of the United States and the corporations. Further, the Act authorized him to return all such assets to the state rural rehabilitation corporations upon proper request by their boards of directors. Applications for return of funds were to contain a covenant, "binding upon the applicant when accepted by the Secretary on behalf of the United States, * * * that the returned assets and the income therefrom will be used only for such of the rural rehabilitation purposes permissible under the corporation's charter as may from time to time be agreed upon by the applicant and the Secretary; * * *."

ARRC's assets, however, continued to be held in trust by the United States, under the terms of a series of trust agreements which continued until 1970. An example of such an agreement is in evidence in this case. Under date of September 7, 1962, ARRC and defendant, acting through the Farmers Home Administration, agreed that the latter would continue to administer certain assets of ARRC, referred to as "the trustor." Article II, section 1, thereof said:

> Section 1. The Government, as provided in this agreement, is hereby authorized to continue to administer, expend and use, *only in the State of the Trustor,* the trust assets * * *. [Emphasis supplied.]

On July 1, 1970, a liquidation agreement executed in April 1970 became effective. Under that agreement, the

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[7] *Id.*

[8] Pub. L. 81–499, ch. 152, 64 Stat. 98 (1950); 40 U.S.C. § 440 (1970) (omitted as executed).

trust assets, "to the extent possible," were to be returned immediately to the Alabama Rural Rehabilitation Corporation, while remaining (unliquidated) trust assets were to be retained and administered by the Government until completely liquidated and returned to ARRC, which promised in the agreement:

> 5. * * * that the assets heretofore, hereby, or hereafter returned to the Corporation by the Government will be used by the Corporation only (1) to make or acquire Farm Ownership or Soil and Water Conservation loans to individuals heretofore or hereafter insured under the Consolidated Farmers Home Administration Act of 1961, as amended (7 U.S.C. 1921 et seq.), and (2) for such other rural rehabilitation purposes permissible under the Corporation's Charter as may from time to time be agreed upon between the Corporation and the Government.

In 1971, ARRC decided to establish a subsidiary for the purpose of providing fire and casualty insurance to Alabama farm families then denied such coverage by regular commercial companies. It proposed such a plan to the Farmers Home Administration on July 19, 1971. FmHA lawyers of the Farm Ownership Loan Division expressed their approval on October 15, 1971, saying that selling such insurance to farmers and ranchers in Alabama was well within the provisions of the charter of ARRC. The Government emphasized that,

> * * * it should be clearly understood that the company's activities should be restricted to rural areas where fire insurance is not available, and to farmers and ranchers in those areas. The coverage offered should be restricted to such insurance as the FHA [FmHA] requires when it makes a loan with either real or chattel property as security.

On October 28, 1971, the proposal was tentatively approved by the Administrator of the FmHA. His letter stated:

> * * * This letter provides approval and consent for use of the assets as you propose, provided the insurance company is established and operated only as a function of the ARRC or a totally owned subsidiary of the ARRC. This consent permits use of the Corporation's assets as required to be pledged in connection with the establishment and operation of this enterprise. It further requires

> the ARRC to obtain the charter for such insurance directly or as a subsidiary operation to be restricted primarily to the providing of rural fire insurance in acceptable areas and only to low income farmers and other low income rural residents in the open country who are unable to obtain satisfactory insurance from other sources.
>
> The consent granted herein is only for the establishment of an enterprise of this nature by the Corporation. When the proposed articles and operational procedures are developed, they should be resubmitted to this office for consideration prior to consummation of the incorporating action and establishment of the company.
>
> * * * Considering the above requirements, the consent granted herewith for use of the Corporation's assets for this purpose is tentative, subject to satisfactory conclusion as to any subsidiary corporation's activities and the further review and consideration of the total transaction by this Agency prior to its consummation.

Despite the requirements of this letter, plaintiff, Alabama Rural Fire Insurance Company, was established as a subsidiary company of ARRC on July 13, 1972, although ARRC seems not to have requested approval by defendant of its incorporation documents until July 27, 1972. In any case, the Farm Ownership Loan Division and the Administrator of FmHA both wrote ARRC on August 7, 1972, giving their respective approvals for the subsidiary. The Administrator's letter referred to his letter of October 28, 1971, and stated:

> This is in response to your letter * * * asking us to concur in the proposal to use Alabama Rural Rehabilitation Corporation assets to establish an insurance company * * *. The company is designed to sell insurance to farmers and ranchers in rural areas of Alabama where it is impossible to obtain insurance from regular commercial companies.
>
> * * * The comments we made regarding the proposal then are still applicable and apply at this time. The proposal is within the provisions of the charter of the Corporation and we concur in use of Corporation assets for this purpose.
>
> It should be clearly understood that the company's activities would be restricted to rural areas where fire

insurance is not available to farmers and ranchers in those areas.

* * * * *

We wish you the best success in this endeavor to use the assets of the Alabama Rural Rehabilitation Corporation to benefit the Alabama rural population. * * *

In accordance with the approval granted by this letter, plaintiff sold insurance to rural Alabamians for about 1 year before it considered expanding its operations. It was the plan to expand which sired this litigation.

Plaintiff's decision to expand the scope of its operations beyond Alabama resulted from the request for proposals referred to earlier, in which defendant sought companies willing to provide "backup" insurance, to provide insurance for—

* * * FHA borrowers who possess adequate insurance at the time a loan is made but who cannot or will not continue to obtain the required insurance. FHA is seeking insurers who will provide, on an annual basis, fire and extended coverage insurance without right of declination or cancellation, on real property that is held as security for an FHA loan. The insurance will cover loss or damage by fire, lightning, windstorm, hail, explosion, riot, civil commotion, aircraft, vehicles, or smoke.

A number of types of properties were listed as being held as security for FmHA loans, including farm properties, single-family housing, multiple-family housing, community facilities, recreation facilities, and business and industrial facilities.

Plaintiff was encouraged by FmHA's Administrator to respond to the request for proposals which, as just indicated, covers five types of properties in addition to farm properties. There is no evidence whatsoever that he suggested that plaintiff submit a bid concerning states other than Alabama. Yet, as indicated at the outset, plaintiff's proposal initially covered 14 states and, after discussions with the contracting officer, covered 49 states and the Virgin Islands. The contracting officer evidently saw no problem with plaintiff's extending its operations beyond the State of Alabama, or he may have thought the

proposal acceptable because plaintiff planned to have a subcontractor issue the insurance in other states.[9] Ultimately, however, he concluded otherwise and on June 11, 1974, rescinded the notice of award which had issued on February 14, 1974, as previously noted.

With this involved background in mind, we can more confidently turn to a discussion of the parties' arguments.

II

The fundamental question in this case is whether it was permissible for plaintiff to contract with the Government to provide insurance outside Alabama. If it was not, the award was a nullity and the Government incurred no liability by rescinding the notice of award. *United States* v. *Mississippi Valley Generating Co.*, 364 U.S. 520 (1961); *John Reiner & Co.* v. *United States*, 163 Ct. Cl. 381, 386, 325 F.2d 438, 440 (1963), *cert. denied*, 377 U.S. 931 (1964). Accordingly, we must determine whether the contract contemplated here was forbidden by statute or the agreement between ARRC and the Government.

The Government's basic contention is that ARRC's proposal involved prohibited activities because it required plaintiff to provide insurance in 14 (later 49) states, although plaintiff was forbidden to apply its assets elsewhere than in Alabama. Plaintiff's principal contentions are that the contract was permissible under the terms of its charter and of its parent's charter, that the activities involved could only help, but not hurt, rural Alabamians, that nothing in the statutes, regulations, or agreements prohibited the enterprise contemplated, and that defendant approved plaintiff's undertaking. We are persuaded that defendant is correct.[10] First we look to the case law for an understanding of the applicable legal standards.

[9] There is some ambiguity concerning when plaintiff first notified FmHA of its intention to use a subcontractor to issue insurance in states other than Alabama, but resolution of this matter is unnecessary for the disposition of this case. We note, in passing, that the agreement between Alabama Rural Fire Ins. Co. and its subcontractor, Republic Service Co. of America, was entered into in March 1974. It was explicit in recognizing that issuing insurance outside Alabama was beyond plaintiff's abilities.

[10] The contrary conclusion of an Alabama district judge does not concern us, for the United States Circuit Court of Appeals for the Fifth Circuit held that he lacked

The parties rely on opposing lines of cases. Plaintiff works from *John Reiner & Co.* v. *United States* (hereafter *Reiner*), *supra*, and cases endorsing the principles there stated. In *Reiner*, the court held that, where the problem of legality of a contract was raised following award, the "court should ordinarily impose the binding stamp of nullity only when the illegality is plain." 163 Ct. Cl. at 386, 325 F.2d at 440. If the contracting officer has viewed the award as lawful, and it is reasonable to take such a view under the applicable statutes and regulations, the court should normally follow suit. *Id.* Therefore, the court stated, unless the invalidity of the award is clear, the contractor should be given the benefit of reasonable doubts and the award should be upheld. *Id.*

Defendant responds that the *Reiner* principles may be fine law but have no application here. Claiming that *Reiner* speaks to situations where the award's legality is *arguable*, defendant first contends that the award here was in *clear* conflict with the Rural Rehabilitation Corporation Trust Liquidation Act, several sections of the Federal Procurement Regulations, and the terms of agreements between defendant and ARRC. Defendant claims that the controlling cases are those such as *Schoenbrod* v. *United States*, 187 Ct. Cl. 627, 410 F.2d 400 (1969), and *Prestex Inc.* v. *United States*, 162 Ct. Cl. 620, 320 F.2d 367 (1963), in which noncompliance with statute or regulation made awards invalid. Plaintiff in turn argues that these cases are inapposite. Noting that *Schoenbrod* distinguished the *Reiner* line of cases by saying the illegality of the award in *Schoenbrod* was plain on the face of the statute and regulations, plaintiff contends that the face of the statute and regulations relied on by defendant here are insufficient to establish the illegality of the award. This point defendant conceded at oral argument, admitting that reference to legislative history and to the agreements between ARRC and defendant is necessary to prove its case.

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jurisdiction of the case, and that plaintiff's exclusive remedy is a suit for damages for breach of contract in the United States Court of Claims. *Alabama Rural Fire Ins. Co.* v. *Naylor*, 530 F.2d 1221 (5th Cir. 1976).

Nonetheless, we think that *Prestex* is more analogous than *Reiner*. The reason for this is that plaintiff's argument relies too much on *Schoenbrod's* reference to illegality appearing on the face of the statute or regulations. What these opposing lines of cases reveal is that ambiguities concerning the legality of awards are resolved in the contractor's favor, but a clear showing of illegality in an award precludes any contract from arising. *Reiner* teaches that illegality must be clearly shown before a contract award will be invalidated. We hold, however, that illegality may be proved with reference to legislative history or agreements restricting a party's ability to contract. Otherwise stated, an unambiguous showing that a purported contract is impermissible will prevent an enforceable agreement from arising. This court is bound to strike down illegal contracts no matter how that illegality is proved.

The Rural Rehabilitation Corporation Trust Liquidation Act explicitly restricts[11] the use of assets returned to ARRC by the Federal Government to—

> * * * such of the rural rehabilitation purposes permissible under the corporation's charter as may from time to time be agreed upon by the applicant and the Secretary, * * *

We find no evidence to support plaintiff's claim that the necessary approval was obtained for contracting to provide insurance in 49 states, and there is abundant evidence that the Government did *not* grant such approval.

Plaintiff makes much of the broad powers in ARRC's charter emphasizing that ARRC's enumerated powers covered a wide range:

> III. D. To assist in the organization of subsidiary and related corporations * * *
>
> * * * * * *
>
> H. To enter into, make and perform contracts of every kind and description and to cooperate with any person, partnership, association, corporation,

[11] More specifically, the Act requires that applications for return of trust funds contain "a covenant, binding upon the applicant when accepted by the Secretary on behalf of the United States, * * *" that the payments will be used in accordance with the language quoted above.

> municipality, county, state, body politic, government, colony or dependence thereof;
>
> * * * * *
>
> L. In general, to carry on any and all business and to do any other act * * * necessary or convenient to the attainment of the foregoing objects, powers and purposes * * *

Plaintiff argues that the Government's approval of ARRC and its charter evidences an agreement by the Government that plaintiff's activities were not intended to be confined to Alabama. But this argument ignores the language of the statute just quoted, requiring that returned assets be used only for activities which were both permissible under the corporation's charter and agreed to by the Secretary. To say the Secretary's approval of ARRC's broad charter constituted such approval would be to render surplusage the statutory language "such of [the purposes permissible under the charter] as may from time to time be agreed upon * * *." The issue is not what ARRC's charter said but what the parties agreed to under the charter's statutory restrictions.

Plaintiff also contends that the Government authorized plaintiff's performance of activities contemplated by the award in question by approving the establishment of plaintiff as ARRC's subsidiary. For this argument, plaintiff relies heavily on the broad statements in plaintiff's articles of incorporation, which were submitted to the FmHA 10 days prior to the 1972 approval for the formation of plaintiff by the Administrator. But it is well known that such certificates often include boilerplate language authorizing all manner of activities which are not actually intended and in any case the Administrator's approval was quite specifically limited to authorizing a company "designed to sell insurance to farmers and ranchers in rural areas of Alabama where it is impossible to obtain insurance from regular commercial companies." Anyway, the provision of the articles of incorporation upon which plaintiff relies states as one of 11 detailed paragraphs of its "purposes, objects and powers":

> ART. II (h) To enter into and make all necessary contracts and agreements for its business with any person, partnership, association or corporation of any domestic or foreign state, government or governmental authority or any political or administrative subdivision or department thereof and to perform and carry out, assign, cancel or rescind any such contracts.

Surely this provision is a statement of the corporation's powers to be exercised in the performance of its lawful business, that of providing insurance to rural Alabamians. The provision, and defendant's approval of the articles in which it is found, cannot reasonably be read as authorizing plaintiff to engage in any form of business which might be the subject of a contract with any person or government, for there would be no limits on what plaintiff could undertake. The only reasonable way to read the articles of incorporation and defendant's letters approving the creation of plaintiff is to say that plaintiff was empowered to enter into contracts anywhere but only when incidental to the provision of insurance to rural Alabamians.

Plaintiff next suggests that, even if it were not authorized to issue insurance outside Alabama, its contract to provide insurance in 49 states was permissible because a subcontractor would have been used to issue the insurance in the other states. Under the terms of plaintiff's arrangement with Old Republic Insurance Company, that company, and not plaintiff, would have been the one liable on claims by insured parties claiming under their insurance policies. A corollary argument is that the contract to provide insurance outside Alabama could not hurt, but could only help, Alabamians. This argument rests on the conclusion that plaintiff's share of the profits derived from insurance policies sold outside Alabama could only increase the funds available for use inside Alabama, thus benefiting the rural population of Alabama.

The principal defect in these arguments is that they assume the success of the enterprise to provide insurance outside Alabama and overlook the possibility that unexpected events related to the provision of insurance outside Alabama might cause plaintiff's assets to be reduced. But what if the unlikely were to occur, and Old Republic

somehow became unable to meet its obligation to provide insurance?[12] Plaintiff would have to find another subcontractor, or else fail in its obligations to defendant. If plaintiff had been unable to find a suitable replacement, plaintiff would have been liable for defendant's costs in finding someone to undertake the obligations for which, under the terms of the contract between plaintiff and defendant, plaintiff was primarily liable.[13]

The risk of losses or default by plaintiff's subcontractor is not the only way in which the contract here put Alabama assets to forbidden use. It did so by permitting plaintiff's executive vice president, Howard Barton, who was on plaintiff's payroll, to put roughly 80–90 percent of his work time toward Old Republic Company, work which he admitted extended far beyond the confines of the State of Alabama. In addition, plaintiff paid the travel expenses of Mr. Barton, although those expenses were associated with arrangements for the provision of insurance in states other than Alabama.

Other defects mar plaintiff's arguments. Its line of reasoning carries it too far. For example, if plaintiff were allowed to contract to provide insurance outside Alabama, so long as it used a subcontractor, why could it not, through subcontractors, operate oil wells in Texas or resorts in the Catskills? Such activities are clearly beyond the scope of the limited purposes for which plaintiff was approved, and so, too, is the provision of insurance outside Alabama. To this plaintiff might respond that operation of oil wells and resorts does not suit the purposes of the Rural Rehabilitation Corporation Trust Liquidation Act, while providing back-up insurance in the several states does serve those purposes. We would disagree. The purposes of the Act are served only when state rural rehabilitation corporations and their subsidiaries limit their conduct of business to the

[12] Admittedly, reinsurance arrangements reduced the risk that great losses would fall upon plaintiff, but the possibility for such losses cannot be denied.

[13] Plaintiff seemed to contend at oral argument that the Government's approval of Old Republic as a subcontractor eliminated plaintiff's potential for liability should events go awry, but no suggestion was made that this approval worked a novation or otherwise discharged the liability plaintiff would have had on its contract with defendant.

states of their incorporation.[14] The legislative history concerning rural rehabilitation corporations unmistakably evidences a congressional determination, faithfully and consistently complied with by executive agencies, that such corporations were to operate solely for the benefit of citizens of the states where they were incorporated.

Plaintiff finally contends that the award itself constituted such approval as was necessary to permit plaintiff to provide insurance outside Alabama. Plaintiff emphasizes that the Administrator of FmHA specifically invited plaintiff to submit its proposal, although, as we have said, plaintiff does not show us that he asked that the proposal apply to states other than Alabama.[15] Plaintiff also relies on the role of the contracting officer in expanding the scope of plaintiff's proposal from 14 states to 49. Plaintiff seems to believe that the contracting officer had sufficient authority to approve plaintiff's proposed activities and that such approval was given in the form of a contract award. We do not agree. Plaintiff was forbidden by the terms of ARRC's 1970 agreement with defendant from engaging in activities not specifically approved by the Secretary of Agriculture. Also, defendant allowed plaintiff's creation for the limited purpose of assisting rural Alabamians. That the contracting officer was a delegatee of the Secretary's power to engage insurance providers does *not* mean that he was authorized to determine, in accordance with the terms of the liquidation agreement between the Government and ARRC, whether providing insurance outside Alabama was a permissible activity for plaintiff. The United States is not bound by the unauthorized acts of its agents. *Federal Crop Ins. Corp.* v. *Merrill*, 332 U.S. 380, 384 (1947). Plaintiff has the burden of showing that the acts upon which it relies

[14] As we have already indicated, it makes no difference that plaintiff intended to use a subcontractor to issue the insurance in states other than Alabama. Plaintiff would have been primarily responsible to defendant for the fulfillment of the promise to provide the insurance, and undertaking that obligation was beyond the limited purpose for which plaintiff was approved and it applied Alabama assets to forbidden use.

[15] Although this is speculation, we think the probable explanation for the Administrator's encouragement to plaintiff to submit a proposal is that he thought plaintiff might wish to broaden the scope of its insurance activities *within Alabama*. The request for proposals, after all, concerned a broader range of insurance than plaintiff was originally offering to its Alabama clientele, as we have shown above.

were authorized. *Housing Corp. of America* v. *United States*, 199 Ct. Cl. 705, 711–12, 468 F.2d 922, 925 (1972). On this record we cannot conclude that the contracting officer had the authority plaintiff claims he had,[16] and in fact the evidence indicates otherwise. The Secretary, acting through the Administrator of the FmHA, gave a limited approval to the activities of plaintiff, and this approval was not broad enough to cover the activities contemplated by the contract. There is no more to this case than that.

We have discussed the failure of defendant to approve the enterprise contemplated by the proposal to provide insurance outside Alabama, and we have shown reasons why such an enterprise was not approved. We believe this discussion also shows why the contract defendant rescinded was illegal under the Rural Rehabilitation Corporation Trust Liquidation Act. It is true that the Act relies primarily on the Secretary of Agriculture (and his agents) to determine the permissible scope of activities of rural rehabilitation corporations, but the Act's legislative history makes it clear that Congress intended that the assets of state rural rehabilitation corporations were to be used *only* for the benefit of their respective states. S. REP. No. 403 is replete with language evidencing Congress' intent.

> It should be noted that the Federal Emergency Relief Administration funds with which the present corporation trust assets were acquired in whole or in part, were granted to the States or corporations without any provision for their return to the United States, and that the principal condition placed upon them was that they be used for rural rehabilitation purposes in the particular States to which they were granted.
>
> * * * When the assets were transferred to the Federal Government under the terms of the transfer agreements, it was upon the specific condition that they be used only in a trust capacity in the appropriate States. * * * [S. REP. No. 403, *supra* note 2, at 2203–04.

We believe that Congress intended that the assets being returned to the corporations were to be used only for the benefit of residents of the respective states and that any

[16] Given this failure of proof, we have no need to concern ourselves with the ambiguity over when the contracting officer was first notified about the involvement of Old Republic in the arrangements to provide insurance outside Alabama.

contract award contemplating a broader use of the assets was forbidden. The contract was thus illegal, both under the Act and under Federal Procurement Regulations which required that no contract be made except in compliance with all applicable law and regulations. *See* 41 C.F.R. §§ 1–1.403, 1–1.1203–1(e) (1974). Accordingly, the contract was of no effect. *United States* v. *Acme Process Equip. Co.*, 385 U.S. 138 (1966); *Atlantic Gulf & Pac. Co.* v. *United States*, 207 Ct. Cl. 995 (1975). The rescision thus did not give rise to a legal claim.

Defendant's motion for summary judgment is granted, plaintiff's cross-motion for partial summary judgment is denied, and the petition is dismissed.

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572 F.2d 280

CAMEL MANUFACTURING COMPANY v. THE UNITED STATES

[Nos. 608–71, 38–72, 441–73. Decided February 22, 1978]

ON THE PROOFS

Renegotiation of contracts; redetermination of excessive profits; burden of proof and persuasion; statutory factors.—The Renegotiation Board determined that plaintiff realized $1,375,000 in excessive profits in 1966, 1967 and 1968 on its Government contracts for the manufacture of military tentage items, for which it was obligated to use Government-furnished property (GFP). Plaintiff seeks de novo review of the determination. In addition to its Government contracts, plaintiff also enjoyed a sizable commercial tentage business. It is *held* that as to its new accounting data, plaintiff had the burden of proving the accuracy thereof and bore the risk of non-persuasion. Plaintiff has failed in this regard, and accordingly the financial data presented by defendant, with the exception of the GFP, represents an accurate accounting from which to make statutory comparisons. It is also *held* that the appropriate value of the GFP must be included in plaintiff's review year figures for purposes of renegotiation. Using as standards comparisons with other military tent manufacturers (Comparison X), with plaintiff's own commercial market (Comparison Y), and with plaintiff's base years and review years (Comparison Z) to assist in reconstructing "normality," it is also *held* that plaintiff is entitled to favorable recognition employing Comparison X under the statutory factor of efficiency; that since plaintiff virtually ignored and did not rely

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on the factor of net worth, defendant has carried its burden of proof relying on Comparison Z and plaintiff is not entitled to favorable recognition; as to the statutory factor of extent of risk assumed, if Comparison Y is employed plaintiff is entitled to credit, if Comparison X is employed there is no such entitlement; that plaintiff is entitled to credit under the factor of contribution to the defense effort employing all three comparisons; that plaintiff is entitled to credit for the complex character of its business employing Comparisons Y and Z; and that when the accounting is revised in accordance with Part I of the opinion, plaintiff's profits considerably exceed those of most of its competitors, those of its commercial business, and those of its base years. In its recreation of a "normal" business environment, utilizing as a "starting point" the percentage profit earned by plaintiff in its commercial business, the court *holds* that plaintiff, under the statutory factors, is entitled to a profit adjustment of an additional 4% of its renegotiable sales. Judgment is entered for defendant on its counterclaims for each of the review years in the amounts of $173,322, $358,460 and $357,829, respectively, totalling $889,611, with each of the amounts to be decreased by appropriate tax credits and increased by interest as allowed by law.

Renegotiation of contracts; redetermination of excessive profits; evidence; burden of proof and persuasion.

[1] In renegotiation proceedings in this court, under *Lykes Bros. S.S. v. United States*, 198 Ct. Cl. 312, 459 F. 2d 1393 (1972), the contractor has the initial burden of going forward with evidence proving the accuracy of its financial data, including segregation of the accounting on renegotiable business from nonrenegotiable business and the propriety of its cost allocation under accepted accounting principles; the contractor also has the burden of pleading the statutory factors upon which it relies for favorable reconsideration. Once the contractor has so pleaded and established its *prima facie* case, the burden shifts to the Government to prove that the contractor's profits were excessive and the extent thereof.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; generally.

[2] The redetermination of excessive profits normally consists of two distinct analytical categories, namely: (I) accounting determinations involving (a) total dollar profits and (b) profits as a percentage of sales, and (II) whether or not profits are excessive involving (a) appropriate standards of comparison and (b) statutory factors.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; evidence; burden of proof and persuasion.

[3] Although the final burden of proving excessive profits is on defendant, where the contractor submitted new accounting data (substantially revised from its initial filings with the Board) based only on general allocations rather than on actual costs as shown on its books

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and as audited by defendant for renegotiation purposes, the contractor has the burden of proving the accuracy of its new data, particularly where the figures it disputes are based on its own established accounting system and procedures, and must carry the risk of non-persuasion respecting the new figures. To require defendant to disprove the new data based on defendant's old audit figures, clearly places an inequitable burden on defendant.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; evidence; burden of proof and persuasion.

[4] The fact that the renegotiated contractor is able to produce virtually none of its original accounting data respecting a review year, does not entitle defendant, after the court's acceptance of its accounting figures, to a default judgment for the amount of profits determined excessive by the Board, since defendant still has the burden of proving that the contractor, who has pled, argued and offered proof of benefits deserved under the statutory factors, realized excessive profits.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; Government-furnished property.

[5] For factor analysis purposes in redetermination of excessive profits, the standard for inclusion of Government-furnished property in the sales and cost of material figures is whether a GFP bailee bore virtually the same burden and derived the same benefits in the handling of GFP as would a purchaser of raw material. A negligible difference between the two requires that the GFP be accounted for in the same manner as materials purchased. However, the balancing must be done on the facts of each case; the GFP-included percentage profit figure may not be compared to other GFP-excluded percentage profit figures with expectation of helpful or equitable results.

War and National Defense ⚖59

Administrative practice and procedure; rulings; binding effect of.

[6] An administrative ruling is not due the same deference as a properly issued regulation.

Administrative Law and Procedure ⚖413

Renegotiation of contracts; redetermination of excessive profits; Court of Claims jurisdiction.

[7] The Court of Claims is not bound by the final determination of the Renegotiation Board, but is free to review all of the evidence and arrive at its own determination of excessive profits, if any, realized by a Government contractor. Nor is the court bound by a rule of procedure which the Board applies in reaching its determinations. This is not to say, however, that the court may not benefit from the Board's expertise.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; generally.

[8] To properly determine what profits, if any, of the renegotiated contractor were excessive and the result of the wartime marketplace,

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this court must attempt to reconstruct some sort of normality from what is essentially an abnormal environment, with the ultimate goal being a fair and equitable adjustment which allows a contractor to retain what he has rightfully earned, but requires him to disgorge any sums accrued through profiteering.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; comparisons.

[9] Renegotiation must be a comparative process. If the court's purpose is to construct normality from an abnormal environment, the greater the number of useful comparisons it can make the closer it can come to estimating what a normal business environment might be, whether by comparing a renegotiated contractor's base period to his review years, to other contractors with varying degrees of similarity to him, or to a combination of both.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; standards of comparison.

[10] In considering standards of comparison as a starting point against which to measure renegotiated plaintiff's profits, the Internal Revenue Service listing of corporate incomes in an analogous category but lacking a showing of individual companies' involvement with military tent manufacture, product mix, sales volume, facilities and operations, is unacceptable, particularly where the profit figures are given only as average and plaintiff cannot be assumed to be an average manufacturer. Tax figures are not the same as book figures.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; standards of comparison.

[11] In comparing relative profit figures of competitors, the nature of competition in the market in which those profits were obtained is useful in determining the probative value of those figures and the weight to be given the comparison in a final determination of excessive profits. Where there is proof of a total lack of competition such a comparison may be of virtually no use; where effective competition is proven, the comparison may be useful in "reconstructing normality."

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; standards of comparison.

[12] As a starting point in "reconstructing normality" a comparison with plaintiff's own concurrent commercial market is relevant where defendant has not proved that a viable pricing mechanism did not exist in the commercial market.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; standards of comparison.

[13] As a starting point, in addition to comparison with plaintiff's own commercial market during the review years and comparison with its

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military tent manufacturing competitors who also reported to the Renegotiation Board during plaintiff's review years, use of a comparison involving plaintiff's base years' renegotiable business and its review years' renegotiable business is entitled to weight.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; efficiency of contractor.

[14] If a contractor's increased efficiency is motivated by expectation of increased profits and if the increased efficiency is solely that of scale resulting from increased volume of Government procurement, the Government may reasonably expect in return a price reduction from the contractor. Thus, the type of efficiency asserted by the contracting parties assumes just as much importance as the fact that certain efficiencies existed.

War and National Defense ⚖59

Evidence; hearsay; hearsay exception; regularly kept records.

[15] Reports by Government officials submitted to the Renegotiation Board prepared in the regular course of their employment are acceptable evidence.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; efficiency of contractor.

[16] Although exact dollar values respecting the qualitative statutory factor of efficiency of the contractor may not be readily determinable, difficulties of computation cannot be a ground for the court to ignore the dictates of Congress respecting this factor.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; efficiency of contractor.

[17] Where plaintiff delivered on its military contracts in a precise fashion—on time and within specifications as shown by strict testing—to a greater extent than its competitors, it operated at full capacity and instituted a new work shift, solely at Government request, in response to increased demands and in face of a tight labor market, plaintiff is entitled to favorable recognition for its efficiency.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; generally.

[18] Almost total reliance on one statutory factor—although it be quantitative and highly useful—detracts from the flexibility so vital to achieving the purposes of the Renegotiation Act.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; reasonableness of costs and profits.

[19] Reasonableness of a contractor's costs and profits is the heart of renegotiation and redetermination of excessive profits.

War and National Defense ⚖59

Syllabus

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; extent of risk assumed.

[20] While plaintiff assumed additional risks in performance of its military contracts than it would have faced had it not dealt with the Government, such as risk of sacrificing a developing commercial market, risk of guaranteeing that its products would meet Government specifications stricter than commercial standards, and risk inherent in hiring and training another shift of workers solely at Government request, as against its own commercial business plaintiff is entitled to credit for risk assumed, but is not entitled to such credit as against other military tent manufacturers who apparently would have been compelled to assume many of the same risks. As to risks entailed respecting Government-furnished property, since the difference between plaintiff as a GFP recipient and one who has to seek out a source of supply, is difficult to quantify as too speculative, a qualitative consideration of the benefit to plaintiff is the only approach on the present record.

War and National Defense ⇐59

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; contribution to defense effort.

[21] Plaintiff is entitled to favorable consideration under the statutory contribution to defense effort factor where it hired and trained an additional work shift in order to increase production, solely at Government request, in face of a tight labor market, and assisted competitors and potential competitors at Government request in order to increase production by conducting tours of its plant, exchanging technical information and disclosing scarce sources of supply.

War and National Defense ⇐59

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; character of business.

[22] In the redetermination process, a contractor's profits cannot be diminished merely because it retains all the work and responsibilities and obligations itself, rather than subcontracting.

War and National Defense ⇐59

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; character of business.

[23] Although the parties presented no evidence concerning the rate of turn-over of products or inventory and the source of materials used has been given consideration under the risk factor, plaintiff is entitled to favorable consideration under the character of business factor in view of the constantly increasing complexities in the manufacturing process during the review years as compared to the base years, and the increasingly sophisticated products produced during the review years.

War and National Defense ⇐59

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; reasonableness of costs and profits.

[24] While a renegotiated contractor's reliance on generalities respecting its financial data may be sufficient to demonstrate a *prima facie*

entitlement to some credit under a particular statutory factor, generalities are insufficient to prove a quantitative entitlement; therefore, the court must not only balance such generalities against defendant's specifics to determine whether the latter has carried its burden, but also assign some arbitrary value to said generalities where it has been determined that defendant's proof is insufficient to carry its burden.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; reasonableness of costs and profits. [25] In determining a reasonable profit for a renegotiated contractor, a broad brush approach is appropriate so long as the record evidence is sufficient to permit a responsible judgmental profit adjustment under the various statutory factors.

War and National Defense ⚖59

Peter M. Kilcullen, attorney of record, for plaintiff. *Kilcullen, Smith & Haneen,* and *John T. Koehler, Hudson, Creyke, Koehler & Tacke,* of counsel.

Lenore C. Garon, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant. *Gerald D. Freed,* of counsel.

Before LARAMORE, *Senior Judge,* KUNZIG and BENNETT, *Judges.*

KUNZIG, *Judge,* delivered the opinion of the court:

These renegotiation cases come before the court on defendant's exceptions to the findings of fact, conclusions of law, and recommended opinion issued by Trial Judge Louis Spector on November 18, 1976, in accordance with Rule 134(h), in which he held that Camel Manufacturing Company (Camel or plaintiff) had realized no excessive profits during the fiscal years in issue. Plaintiff initially brought these actions seeking redetermination of orders of the Renegotiation Board (the Board) that plaintiff had realized excessive profits on Government contracts, during its 1966, 1967 and 1968 fiscal years (review years) in respective amounts of $200,000, $600,000 and $575,000[1]. Plaintiff was successful in its redetermination efforts

[1] Total profits on renegotiable sales during the review years as determined by the Board were $523,595, $939,733 and $1,024,736 respectively.

before the Trial Judge (who reduced the excessive profits to zero), and defendant now argues to this court that the decision of the Trial Judge should be, in effect, reversed on several grounds and that a judgment should be entered against plaintiff for at least the full amount of the aggregate excessive profits as determined by the Board, $1,375,000[2]. We can agree totally with neither the plaintiff (and the Trial Judge) nor the defendant, and hold, for the reasons stated below, that plaintiff realized a total of $889,611 in excessive profits for the three review years. All facts necessary to the decision are contained in this opinion.

The Camel Manufacturing Company was established as a proprietorship in 1923 and was incorporated under the laws of Tennessee in 1946; its principal place of business remains Knoxville, Tennessee. In 1949, it undertook what was to remain its primary activity through the early 1960's, the manufacture of tents and other canvas products for defense agencies of the United States Government. Although its main production consisted of larger canvas items, it also manufactured such diverse items as duffel bags, packs, and mattress covers.

Beginning in 1960, with the installation of Gene B. Laxer as president and general manager, Camel began a long-range growth program which included extensive entry into the commercial tentage and camping equipment market, which it had previously explored only peripherally. By 1963, commercial sales volume had increased so significantly that plaintiff was forced to expand to meet the rising commercial demand. This expansion consisted of enlargement of existing production facilities as well as rental and construction of new facilities. After that time, the commercial segment of plaintiff's business continued to grow rapidly in comparison with its defense agency business.

In fiscal years (FY) 1966, 1967 and 1968, plaintiff accepted sizeable contracts, awarded by the Defense Personnel Support Center (DPSC), for military tentage

[2] The Government counterclaimed for at least the $1,375,000 determined excessive by the Board and argued at trial that Camel realized more than $1,800,000 in excessive profits.

items. Profits earned under these contracts were subject to the provisions of the Renegotiation Act of 1951 (the Act), 50 U.S.C. App. §§ 1211–24 (1970).

By the terms of plaintiff's review year contracts with DPSC, plaintiff was obligated to use certain Government-furnished property (GFP)[3], in the nature of tentage materials such as canvas and webbing, in the manufacture of tents. The Trial Judge found that the value of the GFP utilized by plaintiff in specified FYs was as follows:

FY 1964	$ 825,321
FY 1965	1,560,541
FY 1966	2,173,601
FY 1967	3,309,197
FY 1968	3,221,823

Neither party takes exception to these figures and our review indicates no reason to disturb them.

As stated above, the contracts during the review years were subject to renegotiation. In the instant cases, the Board entered three unilateral orders against Camel, directing refunds of the following amounts as excessive profits allegedly earned in the three review years:

FY 1966	$200,000	Order of May 28, 1970
FY 1967	600,000	Order of November 4, 1971
FY 1968	575,000	Order of August 27, 1973

These three orders are now on appeal before this court, pursuant to § 108 of the Act which provides for *de novo* review.

The record emphatically demonstrates that, from the time of its inception, this action, combining for purposes of redetermination the separate suits filed for each of the review years, was difficult and complex. The plaintiff and defendant could agree on only four, relatively minor, stipulations and, seemingly, every other fact or figure

[3] The items supplied by the Government consisted of canvas products which were utilized in the final manufacture of tents. Though Government furnished material (GFM) would also be an appropriate designation, we shall term these items, as did the Trial Judge—Government furnished property (GFP).

became a bone of contention between the parties. With so many facts contested, the relative burdens of proof assumed vital importance.

The burdens of proof of each of the parties to a renegotiation proceeding in this court were first delineated in the landmark decision in *Lykes Bros. S.S. Co., Inc.* v. *United States*, 198 Ct.Cl. 312, 327–330, 459 F.2d 1393, 1401–03 (1972) [hereinafter cited as *Lykes Bros.*]. In *Lykes Bros.*, this court clearly divided the burden of proof, and the consequent risk of non-persuasion, between the parties, requiring each to carry the burden at a different stage of the proceedings.

Plaintiff's burden, whenever there is a dispute concerning financial data, is to go

> . . . forward with evidence proving the accuracy of the financial data, including the segregation of the accounting on renegotiable business from non-renegotiable business and the propriety of plaintiff's cost allocations under accepted accounting principles. *Lykes Bros.*, 198 Ct.Cl. at 326, 459 F.2d at 1401.

Plaintiff also has the burden of pleading the statutory factors upon which it relies for favorable consideration and of establishing a *prima facie* case under each; however, this court, in an "exercise of discretion," has held that this is only an initial burden and that, once plaintiff has pleaded these factors and established its *prima facie* case, "the burden shifts to the Government to prove that plaintiff's profits were excessive and the extent thereof." *Lykes Bros.*, 198 Ct.Cl. at 327, 459 F.2d at 1402.

As is indicated by this division of the burden of proof, we understand renegotiation cases to consist normally of two distinct analytical categories:

I. ACCOUNTING DETERMINATIONS

A. Total Dollar Profits
B. Profits as a Percentage of Sales

II. ARE PROFITS EXCESSIVE?

A. Appropriate Standards of Comparison
B. Statutory Factors

A brief analysis of the meaning of these four vital headings might well help our discussion at this point:

I. ACCOUNTING DETERMINATIONS

A. *Total Dollar Profits:* This portion of the case is devoted to ascertaining how many dollars of profit the contractor actually earned on his renegotiable contracts. As the *Lykes Bros.* court pointed out, this may often be a stipulated fact, based on figures submitted by plaintiff or obtained by defendant's audit from plaintiff's books. It may, however, be an item of dispute to be resolved at trial. In any event, a dollar figure representing the plaintiff's renegotiable profit is a first step in any renegotiation proceeding.

B. *Profits as a Percentage of Sales:* In order properly to compare the dollar profit figure obtained, it must be converted into figures which relate to other manufacturers' or other years' profit figures. This is most frequently done by comparing the dollar profit figure to the total sales figure to obtain a percentage profit figure which can then be related to other percentage profit figures. In this step of the process, the inclusion or exclusion of GFP in total sales plays a central role, since a smaller total sales figure (with GFP excluded) would make a constant dollar profit figure become a larger percentage profit.

II. ARE PROFITS EXCESSIVE?

A. *Appropriate Standards of Comparison:* Once a percentage profit figure is determined, it must be compared to some other figures to determine excessiveness. Much of the litigation process in this, and other cases is concerned with ascertaining the relative merits of each of many asserted comparisons. In selecting the proper comparisons, the similarity between the asserted standard and the contractor's renegotiable operations is of utmost importance. Once the more appropriate standards are delineated, the apparent excessiveness of plaintiff's profits can be determined by comparison with the standard profits.

B. *Statutory Factors:* Although plaintiff's profits may appear high upon initial comparison to the standard, we are directed by the Act, as the final step to this process, to give consideration to certain "statutory factors"[4] in deter-

[4] The "statutory factors," provided by the Act, listed in the order in which we shall

mining whether or not these profits are in fact "excessive." High profits may not be "excessive" profits if they are justified by a statutory factor.

The Trial

Difficulties in this case arose at each stage of the proceedings. Plaintiff entered the trial with a set of financial figures which had been substantially revised from its initial filings with the Renegotiation Board[5] and from its own books as they had appeared at the time of the Government audit for renegotiation purposes. Plaintiff's new figures were, of course, far more favorable to plaintiff's cause, showing much smaller dollar figures for net renegotiable profits and much larger figures for net commercial profits. This was largely the result of a reallocation of costs to its renegotiable from its non-renegotiable work. In addition, plaintiff's pre-trial accounting figures included the value of the GFP in arriving at the total volume of the renegotiable contracts, against which dollar profits had to be compared to arrive at percentage profits. This inclusion, of course, had the effect of lowering plaintiff's apparent percentage profits.

Much of plaintiff's effort at trial was absorbed in introducing these figures into evidence through the testimony of a Mr. Bone, an accountant, and Mr. Laxer, Camel's president. Plaintiff also produced the testimony of Mr. Laxer and officers of several other companies (which

consider them, *infra*, are:
(1) Efficiency
(2) Net Worth (and capital employed)
(3) Extent of Risk Assumed
(4) Nature and Extent of Contribution to the Defense Effort
(5) Character of Business
(6) Reasonableness of Costs and Profits
(7) Other Factors (as required by the public interest and fair and equitable dealing) 50 U.S.C. App. § 1213(e)(1970).

[5] Plaintiff had filed the required forms RB–1 with the Renegotiation Board for each of the review years. It was not until Renegotiation orders were handed down by the Board claiming plaintiff owed large sums to the Government for excessive profits for two of the three years that plaintiff sought to change its figures and amend its RB–1s. The Renegotiation Board Form 1, "Standard Form of Contractor's Report," delineated in 32 C.F.R. § 1427.702(d)(1976) is the vehicle by which renegotiable contractors file their financial statements with the Board. 32 C.F.R. § 1470 (1976).

made related products) which seemed calculated to achieve a favorable "statutory factors" comparison.

Finally, plaintiff argued that, because its profits were lower than the Government's assertions (in both dollar and percentage figures), because its profits appeared low under all asserted comparisons, and because the statutory factors analysis showed many points favorable to the renegotiated contractor, the court should determine that plaintiff had realized no excessive profits during the review years.

Defendant, on the other hand, introduced as its accounting evidence figures derived from the original, sworn RB-1s which were filed by Camel with the Board for each of the review years and from audits of Camel's books. These figures were supported by the testimony of an FBI agent who had performed audits of Camel's actual records for the review years. Defendant excluded the value of all GFP in computing the total renegotiable sales against which dollar profits had to be compared to arrive at percentage profits. This of course, resulted in a much higher percentage profit than had been indicated by plaintiff's pre-trial accounting figures. Defendant then put on the stand its expert witness, Mr. Katz, who proceeded with an analysis of the percentage profit figure obtained by the Government and how he had compared this figure, against the background of the statutory factors, against figures from Camel's "base years,"[6] in determining which profits were excessive. Defendant also introduced testimony of several other witnesses in an attempt to meet its burden with regard to specific statutory factors.

After an extensive trial, the Trial Judge entered 180 specific findings of fact and produced a recommended opinion which totaled 93 pages. The extensiveness of this fact finding process, together with the length of the opinion, indicates not only the factual difficulty of this case, but also the lack of analytical clarity which still exists in areas of the renegotiation field.

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[6] Camel's FYs 1964 and 1965 were utilized by defendant as "base years" against which "review years" could be compared.

The Appeal

The defendant excepted to this recommended opinion and to the findings of fact and conclusions of law. Having previously discussed the relative burdens of the parties, we will attempt briefly to summarize the Trial Judge's opinion and the arguments of the parties on appeal to avoid placing an excessive burden on the reader.

I. ACCOUNTING DETERMINATIONS

A. *Total Dollar Profits:* The Trial Judge, in his own novel approach to the *Lykes Bros.* opinion, placed *only* a burden of going forward with some evidence on the plaintiff in both Parts I and II of this case.[7] Utilizing this unprecedented approach, it is not surprising that he incorrectly resolved most accounting issues in favor of the plaintiff.

Plaintiff's new accounting data, based on special allocations (created *after* Camel had been before the Board for FYs 1966 and 1967) was allowed into the record by the Trial Judge based on the testimony of plaintiff's recently hired comptroller and its president, Mr. Laxer, who was admittedly unskilled in specialized accounting techniques. Though this testimony was highly generalized and often not based on specific personal knowledge,[8] the Trial Judge determined that it was sufficient to meet plaintiff's burden of "pleading."

On the other hand, the Trial Judge rejected defendant's accounting, which was based on an audit of plaintiff's original, basic documents (in sharp contradistinction to plaintiff's new accounting which was based only on general

[7] The Trial Judge began his reasoning with the statement that:
In accordance with the holding of this court in *Lykes Bros. S.S. Co., Inc.* v. *United States* plaintiff has the initial responsibility of going forward with its evidence in renegotiation, as in all cases. But in renegotiation cases, once it has produced accounting data showing its receipts, costs, and profits, and has brought forward testimony and exhibits demonstrating the so-called "statutory factors" under the Act upon which it relies for favorable consideration, the burden of proof and the risk of non-persuasion as to the existence of and the extent of excessive profits, if any, remains on the defendant.

[8] In response to a question concerning the accuracy of figures put forward in plaintiff's new accounting for FY 1968, Camel's comptroller, hired only a few months before the trial, testified that he was still (at the time of trial) "in the process of trying to prove those figures."

allocations) and offered into evidence on the testimony of defendant's FBI auditor, who had personally inspected Camel's books, where they were available.[9] He further noted that the auditor justified his figures only on the ground that they were taken "directly from plaintiff's cost accounts . . . ." Such justification, the Trial Judge determined, was not sufficient to carry defendant's burden of disproving the figures which plaintiff had introduced into the record.[10]

Just how significant the sum total of all the Trial Judge's accounting determinations in favor of the plaintiff actually were may be seen by comparing the Government's figures with those found to be accurate by the Trial Judge.

Defendant's accounting showed the following picture:

	Renegotiable				Nonrenegotiable			
	(000 omitted)				(000 omitted)			
	Sales	*Costs*	*Profits*	*Profit*	*Sales*	*Costs*	*Profits*	*Profit*
1966	2,780	2,210	570	20.5%	2,684	2,589	115	4.3%
1967	3,808	2,895	940	24.6%	4,097	3,915	189	4.6%
1968	3,798	2,734	1,064	28.0%	5,861	5,472	389	6.6%

Plaintiff's accounting, substantially adopted by the Trial Judge, paints a far different picture:

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[9] Camel could produce almost no documentation for FY 1968 and all of its figures for that year were "derivations" from the general ledger. Defendant's figures for FY 1968 were based on Camel's sworn RB–1 form, which had apparently been prepared and submitted to the Board prior to the loss of the records.

[10] The Trial Judge's overall approach is perhaps best characterized by his statements concerning a relatively minor dispute involving the actual amount of FY 1966 renegotiable sales. In accepting as accurate the plaintiff's figure, he reasoned that defendant's auditor had only:

> . . . testified in general terms that the lower figure was the one *he found upon examination of plaintiff's books* . . . he neither offered a more detailed explanation of the source . . . nor corroborated his opinion by production of photocopies nor by reference to specific ledger or journal entries . . . Since, in contrast to a tax case, no presumption runs in favor of the correctness of accounting figures offered by defendant, the evidence on this minor issue stands, even at best, in equipoise . . . . Plaintiff fulfilled its duty under *Lykes Bros.* when it brought forward its [pre-trial] accounting statements . . . . *Defendant has failed to carry its basic and essential burden of proof by not making its objection to plaintiff's figure more specific, and by not demonstrating by a preponderance of the evidence at trial, the factual basis for the . . . variance it suggests.* (emphasis added).

	Renegotiable				Nonrenegotiable			
	(000 omitted)				(000 omitted)			
	Sales	*Costs*	*Profits*	*Profit*	*Sales*	*Costs*	*Profits*	*Profit*
1966	4,956	4,622	334	6.7%	2,683	2,374	306	11.4%
1967	7,117	6,446	671	9.4%	4,097	3,641	671	16.3%
1968	7,020	6,293	727	10.3%	5,861	5,136	725	12.3%

The difference is clear, and virtually decisive, with renegotiable percentage profits being reduced from 20.5%, 24.6%, and 28.0% (respectively for each of the review years) to 6.7%, 9.4%, and 10.3%.[11]

The defendant took strong exception to the accounting determinations of the Trial Judge. Defendant's arguments essentially center on the contention that the Trial Judge improperly reversed the *Lykes Bros.* burden of proof by allowing the plaintiff to make only unsubstantiated assertions and then requiring defendant to prove them wrong.

The crux of the Government's contention can be found in the following statement:

> If the Trial Judge's findings of fact on accounting (which are also implicity [sic] erroneous conclusions of law), were to be adopted by this Court, it would put the Renegotiation Board in the impossible position of having to accept any contractor's accounting allegations as correct and then undertaking to either verify or disapprove [sic] them in order to survive an appeal in this Court. This would be administratively impossible and abviously [sic] contrary to the expressed intent of the statute. The Board, like the Internal Revenue Service, must place the burden on the taxpayer to back up all of its claimed costs with solid evidence. This Court's evidentiary rules on review must continue to respect these administrative realities.

The Government proceeds to argue that the plaintiff's cost allocations, which had been accepted by the Trial Judge, were totally unsupported by the record and were

[11] The commercial profit has been correspondingly increased from 4.3%, 4.6%, and 6.6% to 11.4%, 16.3% and 12.3%. This increase in commercial profits assumes significance when the renegotiable profits are compared with the commercial profits.

based upon artificial allocations rather than upon actual costs as shown on plaintiff's books. No witness having any part in the preparation of the pretrial statements was brought forward to support them, the only testimony being by the current comptroller who had not participated in their preparation and could offer no explanation of the various apparent discrepancies and by Camel's president, who was admittedly not knowledgeable concerning accounting details.

Camel's response to defendant's overall arguments on total dollar profits and accounting was confined to supporting the findings of the Trial Judge by citing entries in the record demonstrating that plaintiff had met its burden of *pleading* new accounting data.

B. *Profits as a Percentage of Sales:* In determining the percentage profits earned by plaintiff during the review years, the Trial Judge reasoned that the value of GFP "must be taken into the net renegotiable sales figure in computing profit as a percentage of sale" primarily because the "GFP Bailment System" placed the bailee (plaintiff) in "virtually the same position as a materials purchaser as to benefits derived and burdens assumed from its receipt of the GFP." This inclusion of GFP in the total sales and total cost figures resulted in a proportionate reduction in the percentage profit figure which must be compared to determine excessiveness.

The Government argues that the inclusion of the value of GFP violates both a Board regulation[12] and a holding of this court,[13] and asserts that the plaintiff's position vis-a-vis a purchaser of raw materials was vastly superior. The plaintiff, according to the Government, was much better situated than the normal purchaser because it did not have to search out sources of material and because it did not have to worry about normal financing problems or possible cost increases related to materials used in production.

Plaintiff counters that the additional burdens incurred by a GFP recipient more than offset any small benefit which might accrue. Plaintiff notes that the Trial Judge

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[12] 32 C.F.R. § 1499.1–24 (1976).

[13] *Citing Major Coat Co., Inc.* v. *United States*, 211 Ct.Cl. 1, 543 F.2d 97 (1976).

found detriments to the plaintiff in such arrangements as plaintiff's contractual inability to shop around for lower price goods, plaintiff's contractual obligation to accept from the Government up to 10% "short" pieces (which increased plaintiff's costs of production), and plaintiff's contractual responsibility to account for and to store separately the GFP. Plaintiff, in summary, contends that the Trial Judge was correct in finding that plaintiff stood in "virtually the same position as the purchaser of raw materials."

II. ARE PROFITS EXCESSIVE?

A. *Appropriate Standards of Comparison:* The Trial Judge assessed the numerous standards of comparison asserted by the parties and determined that comparisons between plaintiff's commercial and renegotiable business and between plaintiff and four of its major competitors would be the most useful standards for determining excessiveness. He rejected, out of hand, defendant's asserted base years comparison, finding that the differences between the review years and the base years were too great to allow useful comparison.

Defendant argues that the Trial Judge's use of the commercial and competitors standards was in error because both of these standards utilized review year data and the existence of a wartime economy and a general "camping craze" during these years tended to inflate *all* profits. The Government further contended that its use of a base years comparison presented the only proper analysis, since the base years data depicted the profits which would exist absent a war emergency.

Finally, the Government asserts that the dissimilarities between plaintiff and its competitors and between plaintiff's commercial and renegotiable sales were so great as to preclude effective comparisons, while the differences between plaintiff's base years' and review years' renegotiable operations, if any existed, were minimal.

Plaintiff's rejoinder is exactly the opposite of defendant's argument; it cites the Trial Judge's findings of competition in the commercial market and military tent market as supporting the utility of the commercial and competitors comparisons.

B. *Statutory Factors:* The Trial Judge found that the Government had relied on the single statutory factor of net worth to an inordinate extent and then rejected defendant's proof even under that statutory factor because he rejected defendant's base years standard of comparison. He determined that plaintiff had made a *prima facie* case and, therefore, had demonstrated entitlement to some credit under each of the statutory factors.

Yet defendant argued that it had, in fact, properly analyzed and applied the statutory factors with respect to Camel and that it had carried its burden of proof under the statutory factors of efficiency, reasonableness of costs and profits, net worth, extent of risk assumed, and contribution to the defense effort.

Plaintiff not only agrees with the Trial Judge but further counters that any such assertion on the part of defendant is "preposterous" since the government failed to present any competent evidence whatsoever as to any statutory factor other than net worth.

On these difficult and complex questions of law and fact presented to the court, we hold that, with the exception of the exclusion of GFP, the defendant is correct in its statement of the law concerning the accounting portion of this case and that, again with the exception of GFP, the Government's figures represent a correct accounting from which our excessive profits analysis may begin. We also hold, however, that plaintiff is entitled to favorable recognition and credit under several of the statutory factors as outlined in detail below.

At this point, having presented an introduction to the history of the case, the Trial Judge's holdings, a brief explanation of the problems involved and what each party argues, we now move forward to our analysis on review, to our summary and computations and to our final holding.

I. ACCOUNTING DETERMINATIONS

As previously stated, any determination of excessive profits must begin with an accurate accounting—an

accurate statement of the dollar and percentage profits realized by the renegotiated contractor in each of the years under review.

A. *Total Dollar Profits:*

It is well recognized in this court that the final burden of proving excessive profits (and the coincident risk of nonpersuasion) is on the defendant. This does not, however, remove all burdens from the plaintiff, who still bears the responsibility for proving any disputed financial data. Plaintiff's burden was aptly set forth in *Lykes Bros.*[14] The words will bear reemphasis:

> . . . In the course of pretrial proceedings, which may include an audit of plaintiff's books by defendant, the parties will likely stipulate the accuracy of much of the financial data submitted by plaintiff. However, if there is a dispute about such data, plaintiff has the burden of going forward with evidence *proving the accuracy of the financial data,* including the segregation of the accounting on renegotiable business from nonrenegotiable business and the *propriety of plaintiff's cost allocations under accepted accounting principles.* (emphasis added). 198 Ct.Cl. at 326, 459 F.2d at 1401.

The rationale for such a requirement is clear. The plaintiff is in a much better position to prove financial facts concerning its own operations. While the defendant may have (and probably will have) the results of an audit on which to rely, the plaintiff has in its possession and control all essential documents and very probably employs any individuals who could in any way testify with regard to the veracity of various financial data concerning the renegotiated contractor's operations. This makes it much easier for plaintiff to prove the accuracy or inaccuracy of any disputed accounting information.

An interpretation which places both the burden of proof and the risk of non-persuasion *for accounting data* on the plaintiff is also in keeping with the decision of this court in *Aero Spacelines, Inc.* v. *United States,* 208 Ct.Cl. 704, 530 F.2d 324 (1976) [hereinafter cited as *Aero Spacelines*], where this court held:

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[14] *See* p. 469, *supra.*

> Plaintiff employed an established cost accounting method for 1966. Accordingly, in order to persuade the court to use its statutory authority to modify plaintiff's chosen method of accounting, plaintiff must demonstrate that the method actually used does not properly reflect plaintiff's costs. [footnote omitted] 208 Ct.Cl. at 720, 530 F.2d at 335. *See also,* 50 U.S.C. App. § 1213(f)(1970).

Indeed, the situation which faced the court in *Aero Spacelines* is somewhat analogous to the case which confronts us now—a plaintiff seeking redetermination of excessive profits arrived at the trial with a set of accounting figures which were in disagreement with the figures which the plaintiff, itself, had earlier prepared (and, in the present case, submitted to the Board).[15] The clear mandate of both *Lykes Bros.* and *Aero Spacelines*[16] for the case at hand is that the plaintiff must carry the risk of non-persuasion as it attempts to establish its amended figures for each of the review years. In this respect, it was obvious error for the Trial Judge to place that risk on defendant.

The effect of the Trial Judge's misplacing this burden was devastating to the Government, whose entire case was based on the results of an audit which (at least for FYs 1966 and 1967 where plaintiff's original records were available) was conducted on plaintiff's actual, original records and on the sworn RB–1 submission which plaintiff had made to the Board. To allow plaintiff to enter into evidence new data, based solely on the highly generalized testimony of two of plaintiff's officers (who admitted they had neither assisted in the preparation of the earlier documents nor even completely surveyed the original materials), and then to require the defendant to *disprove* this new data based on the old audit figures, clearly places an inequitable burden on the defendant.

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[15] *See also, Bay Co.* v. *Renegotiation Board,* 38 T.C. 535 (1962), where the Tax Court held that a contractor was not permitted under section 103(f)(50 U.S.C. App. § 1213(f)) to change figures developed by a regularly employed cost accounting method unless it demonstrated that such a method was inaccurate.

[16] The burden on plaintiff to prove the accuracy of his financial data was also recognized in *A. C. Ball Co.* v. *United States,* 209 Ct.Cl. 223, 243–4, 531 F.2d 993, 1004 (1976).

In the case at hand, the accounting results of this misplaced burden were multiple. Monetarily, other than the GFP issue which we shall discuss separately, the largest factor involved the plaintiff's reallocation of costs, which the Government characterized as an attempt to load "huge amounts of costs from the commercial business into the renegotiable business."

The relevant figures, as shown by defendant's audit, were as follows:

FY 1966

	Total Business	Renegotiable Business	Commercial Business
Net Sales	$5,465,453.63	$2,780,606.39	$2,684,847.24
Cost of Goods Sold	4,116,760.40	1,947,126.62	2,169,633.78
Selling/Adv. Expense	307,554.97	48,107.53	259,447.44
G&A Expenses	376,209.71	215,236.92	160,972.79
Net Operating Profit	664,928.55	570,135.32	94,793.23
% Profit (of total sales)	12.17%	10.43%	1.74%
% Profit (of Renegot. sales)		20.50%	
% Profit (of Comm. sales)			4.3%[17]

[17] This figure was originally shown as 3.5%, but was subsequently "adjusted" upward to 4.3% by defendant.

[18] Since plaintiff's original records for FY 1968 were not made available to defendant, a complete audit was impossible. Defendant's figures were, therefore, derived from plaintiff's sworn RB–1 filings. Plaintiff, parenthetically, made no effort to explain the absence of the original records.

Plaintiff's original RB–1 filing for FY 1968 showed $1,064,000 in net operating profit for its renegotiable business. The Board "adjusted" that figure downward to $1,024,000, and the Government asserts only this lesser amount. Since this court has no record detailing the basis for the Board's adjustment, and since no testimony was adduced at trial concerning this fact, we determine the figure in plaintiff's sworn RB–1 to be most reliable for purposes of our *de novo* review.

[Text reference to n. 18 is on p. 482.]

FY 1967

	Total Business	Renegotiable Business	Commercial Business
Net Sales	$7,905,020.12	$3,808,248.02	$4,096,772.10
Cost of Goods Sold	5,706,559.26	2,433,550.68	3,273,008.58
Selling/Adv. Expense	557,299.71	155,601.71	401,698.00
G&A Expenses	534,801.79	294,670.03	240,131.76
Other Income	22,717.72	15,307.88	7,409.84
Net Operating Profit	1,129,077.08	939,733.48	189,343.60
% Profit (of total sales)	14.28%	11.89%	2.39%
% Profit (of Renegot. sales)		24.68%	
% Profit (of Comm. sales)			4.62%

FY 1968[18]

	Total Business	Renegotiable Business	Commercial Business
Net Sales	$9,659,000.00	$3,798,000.00	$5,861,000.00
Costs & Expenses	8,206,000.00	2,734,000.00	5,472,000.00
Net Operating Profit	1,453,000.00	1,064,000.00	389,000.00
% Profit (of total sales)	15.04%	11.01%	4.02%
% Profit (of Renegot. sales)		28.01%	
% Profit (of Comm. sales)			6.6%

[Footnote 18 appears on p. 481.]

These figures were entered into the record through the testimony of defendant's witness, Frank Morris, an FBI special agent accountant, who had inspected the records of the company in both 1973 and 1974[19] in a specific effort to develop profit and loss statements for the review years. His testimony at trial demonstrated both the diligence of his efforts to unravel the confusing track of the corporate enterprise and the inexact nature of the accounting science. He did, however, make an effort to relate all of his findings back to the records as they were kept by plaintiff, and to allocate or estimate only where gaps in the documentation or apparent discrepancies made it absolutely necessary.

Plaintiff's figures were not based on actual cost accounts. They were new, special allocations, having been created once the "inaccuracy" of the original records had been "established" by the testimony of Messrs. Bone and Laxer.[20] The sum total of their testimony was to the effect that, although their accounting system showed costs by location of the plant, "some" renegotiable work was performed at plants classified commercial and "some" commercial work was performed at plants classified as renegotiable. Neither man could testify, nor were records produced, concerning the exact amount of costs which were "misplaced" as a result of the alleged inability of the established accounting system properly to reflect costs. Camel's theory of its *Lykes Bros.* burden, apparently accepted by the Trial Judge, seems to be that once it has alleged that some "inaccuracy," regardless of magnitude,

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[19] His 1973 audit was conducted with the assistance of a Mr. Bruce Martin, who was, at that time, Camel's comptroller. His 1974 visit occurred after Mr. Bone had replaced Mr. Martin. Mr. Bob Allen, Camel's comptroller during the review years was not available for any audit procedures, and was not called as a witness by Camel during the trial to substantiate its review years claims. Mr. Hammers, Camel's comptroller when the allocations were made, was not called as a witness and was not deposed.

[20] Mr. Laxer testified that Camel's comptroller at the time of the renegotiation of FYs 1966 and 1967, Mr. Hammers, was "miffed" when he attended a Board session in Washington and discovered that the Board's figures were based exactly on the initially submitted RB–1s. Mr. Laxer further testified that, after he and Mr. Hammers "discussed [the situation] on the way home," Mr. Hammers "reworked the RB–1s making the allocations exactly as Mr. Hammers thought . . . ." Mr. Hammers was not produced to testify.

exists in the figures arrived at through its standard accounting procedures, it may scrap *all* of those figures and calculate totally new figures, based on some allocative ratio of its personal choice, which it then became defendant's burden to disprove.

This is directly opposed, as we have previously discussed, to both the letter and spirit of *Lykes Bros.* and *Aero Spacelines.* It is plaintiff's burden to go "forward with evidence proving the accuracy of the financial data" . . . "and the propriety of plaintiff's cost allocations under accepted accounting principles." This is particularly true where, as here, the figures it disputes are based on its own established accounting system and procedures. The risk of nonpersuasion must also remain on the plaintiff. This distribution of the burden and risk is, indeed, as defendant argues, in keeping with "administrative realities." Neither the Board nor the Act under which it operates could continue to function if this procedure were reversed. The Board, and this court, *must* place the burden on the renegotiated contractor to back up all of its claimed costs with solid evidence. We hold that plaintiff has not sufficiently done so. In this case, Camel has failed to carry its burden.[21]

The failure of proof by the plaintiff extends to all of the accounting data contested by the Government, and the figures put forward by the defendant, as detailed *supra*, are hereby found, with the exception of GFP, to represent an accurate accounting from which all statutory comparisons must begin.[22]

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[21] Because we hold that plaintiff has not carried its burden in any accounting respect, we need not discuss the relative merits of positions taken on such sub-areas as indirect manufacturing, advertising, selling or G&A expense.

[22] With regard specifically to FY 1968, for which plaintiff could produce virtually none of its original records, defendant has asserted that it is entitled to a default judgment for the amount of profits determined excessive by the Board. While we cannot see how plaintiff could hope to carry its burden of proof in the accounting area without maintaining its original documents and records to back up its position, this court's acceptance of defendant's accounting figures does not relieve defendant of its significant burden of proving that plaintiff realized excessive profits. Therefore, while plaintiff's lack of records may constitute a "default" in the accounting area, it in no way entitles defendant to a default judgment for the amount of excessive profits it claims. Plaintiff has pled, argued and offered proof of benefits deserved under statutory factors; to be entitled to judgment, defendant must still overcome these arguments.

B. *Profits as a Percentage of Sales:*

Prior to converting the dollar profits into percentages, however, one significant modification must be made to those figures put forward by the Government. The figures which represent total sales and cost of goods sold must be adjusted upward to reflect the inclusion of GFP. Not only did plaintiff make a far more convincing proof for its position of including GFP, but the standard for inclusion of GFP has been significantly modified by developing case law since general standards were enunciated in *Lykes Bros.*

In *Major Coat,* Judge Bennett undertook a thorough, exhaustive and well-reasoned analysis of the GFP problem. Since the *Major Coat* opinion was authored after the Board's determinations in these consolidated cases, the Board clearly did not have the advantage of the *Major Coat* analysis when it decided to exclude GFP. However, based on *Major Coat,* we find that Trial Judge Spector correctly analyzed the problem and correctly included GFP in the sales and cost of material figures.

In resolving a question of whether inclusion of GFP would be proper, *Major Coat* outlined as the court's task:

> . . . we must determine whether a GFP 'bailee' bore virtually the same burdens and derived the same benefits in the handling of the GFP as would a purchaser of raw materials. A negligible difference between the two requires that the GFP be accounted for in the same manner as materials purchased. 211 Ct.Cl. at 16, 543 F.2d at 106.

We believe this to be a clear and sound statement of the problem before us now.

The Government cites 32 C.F.R. § 1499.1–24 (Renegotiation Ruling No. 24)(1976) in support of its contention that GFP must be excluded in our current analysis. That section states, in part:

> . . . Since the contractor does not purchase, and at no time owns, the Government-furnished materials, his return of the finished product does not constitute a sale of such materials. Therefore, the value of the furnished materials may not be included in renegotiable sales or costs. 32 C.F.R. § 1499.1–24 (d)(1976).

The Government then argues that this "administrative interpretation" if reasonable, *must* be followed by the court. The fallacies of this assertion are numerous.

As plaintiff notes, the cited section constitutes only a ruling and is thus not due the same deference as a properly-issued regulation. In addition, this ruling was issued, in 1969, *after* the FYs under review here. Application of the ruling to exclude GFP in fiscal years prior to its issuance would yield inequitable results and would be, at best, a questionable practice. Finally, and most importantly, the Act itself states in clear and distinct terms that:

> . . . A proceeding before the Court of Claims to finally determine the amount, if any, of excessive profits shall not be treated as a proceeding to review the determination of the Board, but shall be treated as a proceeding de novo. 50 U.S.C. App. § 1218 (Supp. V. 1975).

This language indicates that the Court of Claims is not bound in any way by the final determinations of the Board, but is free to review *all* of the evidence and arrive at its own determinations.[23]

Our court has previously held to this effect. In *Gibraltar Mfg. Co.* v. *United States*, 212 Ct.Cl. 226, 546 F.2d 386 (1976) [hereinafter cited as *Gibraltar*], we stated that:

> . . . We think that in executing our responsibilities under 50 U.S.C. App. § 1218, . . . we may not accord the Board decision a presumption of correctness, or treat it as evidence in support of its conclusion . . . . 212 Ct.Cl. at 229-30, 546 F.2d at 388.

If this court, then, is not bound by a final determination of the Board, why should it be restricted to following, as the Government argues, a rule of procedure which the Board applies in reaching its determinations? There is no convincing reason. Indeed, if we were to accept the Government's assertion as correct, the Board could, conceivably, issue a sufficient number of "rulings" so that its procedures in accounting became so structured as to make

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[23] This specific intent of Congress to remove Renegotiation redetermination proceedings from the normal ambit of judicial review of administrative determinations and proceedings vitiates the "reasonable interpretation" argument put forward by defendant and thereby distinguishes *Port Authority of St. Paul* v. *United States*, 193 Ct.Cl. 108, 432 F.2d 455 (1970), cited by the Government.

the process almost a ministerial function—and this court would be bound by those procedures. We cannot, and will not, accept such reasoning.

The only way in which the purposes of the Act in this regard can properly be achieved is for this court to accord the renegotiated contractor a totally fresh hearing which, from the start, is free from the strictures of Board procedures and any presumption of correctness in the Board's determinations.

This is not to say that we may not benefit from the Board's expertise. Indeed, "we may [often] take a sideways glance at [a Board decision] as a mere suggestion." *Gibraltar*, 212 Ct.Cl. at 230, 546 F.2d at 388. However, after taking our "sideways glance" at the Board ruling here at issue, we believe the rationale of the *Major Coat* analysis to be far superior in fairly determining the GFP issue. If there be, in fact, a "negligible difference" between a recipient of GFP and a regular purchaser of raw materials, then fairness "requires that the GFP be accounted for in the same manner as materials purchased." *Major Coat*, 211 Ct.Cl. at 16, 543 F.2d at 106.

The *Major Coat* opinion analyzed the GFP bailment system at some length and detailed some important touchstones which could be utilized in determining whether more than a "negligible difference" existed between the GFP bailee and the raw materials purchaser. The court there distinguished the GFP bailment system from the earlier "free issue system" (although it noted that under both systems the contractor was "relieved" of both the problem of source location and any difficulties encountered in normal financing), pointing out that, under the GFP bailment system, the entire risk of end-item yield was placed squarely on the contractor.

After carefully balancing the benefits of the GFP bailment system to the contractor against the numerous component risks subsumed in this end-item yield risk, the *Major Coat* court stated:

> On balance, we conclude that, on the facts of this case, the value of the GFP should be taken into the net renegotiable sales figure and included in calculations of renegotiable profit as a percentage of sales, to place

plaintiff on a parity with a manufacturer that purchases all the materials it uses 211 Ct.Cl. at 20, 543 F.2d at 108.

The court also cautioned, however, that it was not enunciating a universal rule of GFP inclusion, that the balancing must be done on the facts of each particular case, and that the GFP-included percentage profit figure could not be compared to other, GFP-excluded percentage profit figures with any expectation of helpful or equitable results.[24]

Applying the *Major Coat* balancing test to the case at hand, we find that the Trial Judge had on the record more than a sufficient number of facts from which he could properly conclude that Camel, as a GFP bailment system bailee, was in "virtually the same position as a materials purchaser as to benefits derived and burdens assumed from its receipt of the GFP." Indeed, the Trial Judge could, and did, find on the basis of the record developed by plaintiff that the plaintiff, as a GFP bailee, assumed obligations, in addition to those of a materials purchaser, which served to offset the benefits argued by the defendant.[25]

We hold that the appropriate value of GFP [26] provided to Camel must be included in its review year figures for purposes of renegotiation. Such inclusion would have the following results on the Government audit figures already approved, with the exception of the GFP issue, as correct statements of plaintiff's review years accounting.[27]

[24] This last caution will assume significance *infra*, when GFP *must* be excluded for comparison with competitors' profit figures, which were obtainable only through the Board and, thus, only on a GFP-excluded basis.

[25] The end-item risks assumed by the plaintiff, and developed on the record, appeared to be many of the same ones discussed in *Major Coat*. These included the risk of underestimating the amount of GFP needed and the entire risk of loss from the time of picking up raw materials to delivering finished goods. In addition, however, the record in *Camel* showed that plaintiff assumed obligations to store and account for GFP separately (from regular inventory), to pay for all transportation expenses, to accept 10% short pieces without additional cost allowances, to accept Government-caused delays in delivery without compensation, and to refrain from contracting with any commercial supplier for the same goods at lower prices.

[26] The appropriate GFP values, stated at p. 468, *supra*, are:

FY 1966—$2,173,601
FY 1967— 3,309,197
FY 1968— 3,221,823

[27] For a discussion and illustration of the proper figures, as put forward by the Government, *see supra* at pp. 481-82. Figures changed as a result of inclusion of GFP are marked *.

FY 1966

	Total Business	Renegotiable Business	Commercial Business
Net Sales	$7,639,054.63*	$4,954,207.39*	$2,684,847.24
Cost of Goods Sold	6,291,361.40*	4,120,727.39*	2,169,633.78
Selling/Adv. Expense	307,554.97	48,107.53	259,447.44
G&A Expenses	376,209.71	215,236.92	160,972.79
Net Operating Profit	664,928.55	570,135.32	94,793.23
% Profit (of total sales)	8.7%*	7.46%*	1.2%*
% Profit (of Renegot. sales)		11.51%*	
% Profit (of Comm. sales)			4.3%*

FY 1967

	Total Business	Renegotiable Business	Commercial Business
Net Sales	$11,214,217.12*	$7,117,445.02*	$4,096,772.10
Cost of Goods Sold	9,015,756.26*	5,724,747.68*	3,273,008.58
Selling/Adv. Expense	557,299.71	155,601.71	401,698.00
G&A Expenses	534,801.79	294,670.03	240,131.76
Other Income	22,717.72	15,307.88	7,409.84
Net Operating Profit	1,129,077.08	939,733.48	189,343.60
% Profit (of total sales)	10.06%*	8.37%*	1.69%*
% Profit (of Renegot. sales)		13.20%*	
% Profit (of Comm. sales)			4.62%*

FY 1968

	Total Business	Renegotiable Business	Commercial Business
Net Sales	$12,880,823.00*	$7,019,823.00*	$5,861,000.00
Cost of Goods Sold	11,427,823.00*	5,955,823.00*	5,472,000.00
Net Operating Profit	1,453,000.00	1,064,000.00	389,000.00
% Profit (of total sales)	11.2%*	8.20%*	3.00%*
% Profit (of Renegot. sales)		15.16%*	
% Profit (of Comm. sales)			6.6%*

As can be seen by a comparison of the GFP-inclusive and the GFP-exclusive tables, the most significant effect of the inclusion of GFP is the reduction of percentage profits (from renegotiable business) from 20.50%, 24.68%, and 28.01%, respectively, for the three review years, to 11.51%, 13.20% and 15.16%, respectively. We further hold, as a matter of fact and of law, that these are the appropriate figures, as developed in the immediately preceding tables, for use in the Standards of Comparison and Statutory Factor analyses which follow.

In summarizing the accounting portion of this opinion (Part I), weighing all the evidence, we hold that defendant has overcome the Rule 147(b) presumption of correctness attaching to Judge Spector's opinion and fact finding, insofar as the Trial Judge misconstrued the *Lykes Bros.—Aero Spacelines* burden of proof requirements and incorrectly accepted as persuasive plaintiff's accounting data. However, we further hold that Judge Spector was correct in denying defendant a default judgment for FY 1968 and

was correct in his inclusion of the value of GFP in figuring percentage profit.

II. ARE PROFITS EXCESSIVE?

With the proper accounting figures thus determined, it is now possible to move on to compare this data, as directed by the statutory factors, against other available data to determine whether the profits realized by Camel were excessive. In this next phase, the determination of excessiveness, the burden of proof shifts to the defendant, who must convince us of both the fact and amount of excessive profits.

A. *Appropriate Standards of Comparison:*

Another vigorously contested aspect of this case involves the proper comparisons to be made in determining what portion, if any, of a company's renegotiable profits were excessive. As previously discussed, the Government asserts that, according to the prior opinions of this court,[28] a "normal years" or "base years" method of analysis constitutes the proper comparison. Plaintiff adopted a more scattershot approach, introducing evidence derived from its own commercial business, its whole group of military tentage competitors, and an Internal Revenue Service grouping of 150 loosely related fabric and textile manufacturers. The Trial Judge assessed this veritable plethora of options and arrived at the conclusion that Camel had realized no excessive profits in any of the review years.

The confusion and disagreement here, as well as the wide range of theories put forth, indicate the need for some further guidelines in this comparative area of renegotiation law. Initially, we should state that we forego the opportunity to wander into the intellectual mine field that is the Government's exercise in semantics concerning whether the Act is primarily aimed at prices or profits. It serves no useful purpose. In fact, in many respects, prices and profits represent two sides of the same coin. For our

[28] *See, e.g., Butkin Precision Mfg. Corp.* v. *United States*, 211 Ct.Cl. 110, 121, 544 F.2d 499, 505 (1976).

purposes, the goals of the Act were more than adequately set forth in *Major Coat:*

> . . . Renegotiation merely seeks to reconstruct the competitive price to the Government, and the *competitive profit for the contractor,* that negotiation would have produced absent the suddenness of wartime demand on the marketplace. 211 Ct.Cl. at 24, 543 F.2d at 110. (emphasis added)

Thus, in order properly to determine what profits of the renegotiated contractor, if any, were excessive and the result of the "suddenness of the wartime demand on the marketplace," this court must attempt to *"reconstruct"* some sort of normality from what is essentially an abnormal environment, the wartime marketplace.[29] The basically theoretical nature of such an attempt at reconstruction often necessitates a "broad brush" approach to the entire matter, *see, e.g., Gibraltar,* 212 Ct.Cl. at 229, 546 F.2d at 388; *A. C. Ball Co.* v. *United States,* 209 Ct.Cl. at 229, 531 F.2d at 996 (1976); with the ultimate goal being a fair and equitable adjustment which allows a contractor to retain what he has rightfully earned, but requires him to disgorge any sums which have accrued to him through what might properly be termed "profiteering."

In undertaking this effort, the court has been directed by statute to consider certain factors. It is what the statute does not say, however, which causes the difficulty; it does not say how, or against what background, we are to "consider" these factors. Since no absolute standards are dictated (which would be virtually impossible to formulate), it seems clear that renegotiation must be a "comparative process." *See, e.g., Major Coat,* 211 Ct.Cl. at 9, 543 F.2d at 102. The goal of this comparative process is to answer a very "important question in renegotiation [which] is . . . where the contractor in a defense industry belongs in the hierarchy of profit returns of industry as a whole and the reason for his being placed in that particular position.' " *Aero Spacelines,* 208 Ct.Cl. at 730, 530 F.2d at 340. (citation omitted)

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[29] *See Mills Mfg. Corp.* v. *United States, post* at 536.

In our previous renegotiation cases, we have formulated a sort of seriatim approach to the consideration of each of the statutory factors. *See, e.g. Major Coat,* 211 Ct.Cl. 1, 543 F.2d 97 (1976); *Butkin,* 211 Ct.Cl. 110, 544 F.2d 499 (1976); *Mason & Hanger,* 207 Ct.Cl. 106, 518 F.2d 1341 (1975). While this approach has enabled us to maintain the flexibility so vital to achieving the purposes of the Act, *see Mason & Hanger,* 207 Ct. Cl. at 115–18, 518 F.2d at 1346–48, (*citing Lichter* v. *United States,* 334 U.S. 742, 773 and n. 18), it has also, apparently, encouraged a scattershot approach by plaintiffs and the Government alike.

In these cases, we have compared renegotiated contractors to themselves (a "base years" or "normal years" approach) *see, e.g. Gibraltar,* 212 Ct.Cl. at 235, 546 F.2d at 391, to other contractors with varying degrees of similarity to the renegotiated contractor, *see, e.g. Major Coat,* 211 Ct.Cl. at 41, 543 F.2d at 120, and to both themselves *and* other contractors, *see, e.g. Mason & Hanger,* 207 Ct.Cl. at 146–7, 518 F.2d at 1365. Of these various approaches, the dual comparison appears most appropriate; in fact, if our purpose is actually to "reconstruct" normality, the greater the number of *useful* comparisons we can make, the closer we can come to estimating what a normal business environment might be. We have often, however, been limited to one comparison or another by the absence or lack of utility of evidence from which to draw any others.

We have also previously recognized that the relative utility of a given comparison is based on the similarities which can be established between the renegotiated contractor and the standard to which we attempt to compare it. *See, e.g., Major Coat,* 211 Ct.Cl. at 42, 543 F.2d at 120. The perhaps inevitable result of our looking at various unrelated standards and attempting to assess the relative utility of each is apparent in the case at hand; the renegotiated contractor and the Government each selects a standard on which to rely and argues the statutory factors in relation to that standard. As a consequence, they almost totally "miss each other" in their attempted proofs; neither adequately answers the other. The result is an incomplete patchwork

of asserted economic data from which we must pick and choose in our attempt to reconstruct normality.[30]

In this case, the proceedings before the Trial Judge represented nearly a classic example of the parties' arguing past each other. The plaintiff, as was its burden under *Lykes Bros.*, went forward by pleading the statutory factors upon which it relied for favorable consideration. However, it chose as standards of comparison its own commercial business and the businesses of other military tent producers and other textile manufacturers. Defendant responded by relying primarily upon the statutory factor of net worth and employment of capital, but it chose as its standard of comparison the plaintiff's own business during the base years. The Trial Judge was thus faced with the monumental task of sorting, picking and choosing among numerous diverse facts in an effort to arrive at a fair and equitable conclusion.

Our next analytical task, then, would appear to involve an evaluation of the asserted standards of comparison, in order that we may determine which of these standards can effectively be utilized as a "starting point" in our determination of excessiveness.

Plaintiff has asserted a number of possible standards against which we could measure its profits. First, it produced evidence of its profitability in comparison with certain of its competitors in various groupings. (For clarity in further discussion, we will term this "competitor's comparison" Comparison X.) The first grouping suggested by plaintiff is a grouping of primarily military tent manufacturers by their earnings on General Purpose Medium (GPM) tent contracts, which contracts constituted the bulk of their renegotiable work. While we decline to utilize this grouping because we do not have sufficient data to determine how properly to calculate plaintiff's GPM profit, as plaintiff would have us do, we note in passing (and taking our "sideways glance" at Board proceedings) that these contractors with similar volume, whose GPM

[30] This court has previously noted its frustrations with the patchwork nature of the evidence before it. *See, e.g., Gibraltar*, 212 Ct.Cl. at 240, 546 F.2d at 394; *Major Coat*, 211 Ct.Cl. at 48, 543 F.2d at 124; *Aero Spacelines*, 208 Ct.Cl. at 730, 530 F.2d at 340.

tent contracts constituted significant portions of their renegotiable work, had their GPM profits renegotiated by the Board to 14.1%[31] in FY 1966 and to between 13.6% and 15.4% in FY 1967. While these figures may be of questionable probative value since we have no record of the Board's deliberations in obtaining them, they may constitute a useful background by indicating what the Board, in exercising its experience and expertise, believed to constitute a "normal" profit in each of those FYs.

Plaintiff's second suggested grouping under Comparison X is more generalized, consisting of all military tent makers earning profits within the review period and reporting to the Board. This grouping consisted of plaintiff's regular competitors, plus ten other firms without such prior experience, who joined the military tent market during the review years. A table of this comparison could be depicted as follows:[32]

Comparison X

FY 1966	*Plaintiff*	*Others*	*No. of Others*
Sales range	$2.8 million	$1.4-$2.8 million	(4)
Actual profit	20.50%	9.2%-34.4%	
After Board action	**	9.2%-15.4%	
FY 1967	*Plaintiff*	*Others*	*No. of Others*
Sales range	$3.8 million	$1.1-$6.7 million	(7)
Actual profit	24.68%	6.9%-39.1%	
After Board action	**	6.9%-15.4%	
FY 1968	*Plaintiff*	*Others*	*No. of Others*
Sales range	$3.8 million	$1.1-$5.4 million	(11)
Actual profit	28.01%	7.6%-50.0%	
After Board action	**	6.8%-15.6%	

[31] These figures are GFP-exclusive, since no GFP-inclusive figures are available from the Board. This 14.1% was renegotiated down from 34.4%; the other competitor, earning only 9.2% escaped renegotiation in FY 1966.

[32] Again, since the Board does not supply figures on a GFP-inclusive basis, the comparison must be made exclusive of GFP.

Plaintiff's third suggested grouping under Comparison X involved companies listed by the IRS in its Corporation Source Books of Statistics of Income under IRS's Standard Enterprise Classification 2398. This grouping consisted of 150 "Miscellaneous Fabricated Textile Producers" (of which Camel was one) with assets between $1 million and $5 million. Unfortunately, the IRS statistics (as presented by plaintiff) show nothing about individual companies' involvement with military tent manufacturing, product mix, sales volume or facilities and operations. More importantly, however, the IRS profit figures are given only as averages and, therefore, are not useful to us since we cannot assume Camel to have been merely an average manufacturer.[33] In any event, tax figures are not the same as book figures.

Thus, the first and third of plaintiff's suggested groupings under Comparison X must be rejected outright. We also note, as did the Trial Judge and the Government, significant difficulties with the second suggested grouping. The review period product mixes for most of the other manufacturers are unknown, as are the nature and similarity of the other manufacturers' plants and operating facilities. Perhaps the most troublesome factor, however, is the one pointed out by the Government. In any comparison with competitors during a year under review, there exists the danger that the competitors' profits, too, will be excessive because of a generally overheated market. The Trial Judge, aware of this problem, noted that the situation here was not as non-competitive as the situation in *Major Coat*, where the Government was forced to resort to "rated orders."[34] The Government cites this language of the Trial Judge concerning "competition" as evidence that he confused antitrust law with renegotiation law.[35] We do not believe this to be the case. Certainly, when one is comparing relative profit figures, the nature of competition

[33] *See, A. C. Ball*, 209 Ct.Cl. at 263, 531 F.2d at 1015; *see also, Major Coat*, 211 Ct.Cl. at 36, 543 F.2d at 117.

[34] A rated order is an emergency procurement device which legally obligates a contractor to accept a Government procurement contract. 50 U.S.C. App. § 2071 (1970). *See also, Major Coat*, 211 Ct.Cl. at 11, 543 F.2d at 103.

[35] The Government drew a similar conclusion from the Trial Judge's discussion of a "viable pricing mechanism" in the plaintiff's commercial market.

in the market in which those profits were obtained will be useful in determining the probative value of those figures and the weight which should be given the comparison in a final determination of "excessiveness." Where there is proof of a total lack of competition, such a comparison may be of virtually no use, *see, e.g., Major Coat*, 211 Ct.Cl. at —, 543 F.2d at 113; on the other hand, where effective competition is proven, such a comparison may be quite useful in "reconstructing normality."

The case at hand appears to present a sort of middle of the road situation—not as non-competitive as the one in *Major Coat*, and yet certainly not a model of a fully competitive market. We must take this factor into account in weighing Comparison X. Also, in taking yet another "sideways glance" at the Board's determinations, we note that the Board considered up to a 15.6% profit to be "normal."[36]

Despite the problems noted and the cited dissimilarities, we find that plaintiff's Comparison X, when the grouping of all other military tent manufacturers is employed, may be of value to us in determining what constituted "normal" profits during the review years, so long as an appropriate discount in probative weight is allowed for the cited difficulties with this standard.

The plaintiff asserts yet another comparison which it claims will assist us in our task of reconstructing normality, a comparison with plaintiff's own commercial market (Comparison Y). The Trial Judge considered plaintiff's evidence disclosing its own profitability in *commercial* sales to be "highly relevant" for the purpose of establishing an index of reasonable profit in the pertinent commercial sector. He, in turn, considered the commercial market to paint an excellent picture of "normality" because the Government presented no evidence that a "viable pricing mechanism" did not exist in the concurrent commercial market.

As with Comparison X, we note the difficulties in comparing the plaintiff's renegotiable business with its commercial business. For example, the Government has

[36] Such a "sideways glance" at profit figures found reasonable by the Board was also taken by the court in *Mills Mfg. Corp.* v. *United States*, *post* at 568-70.

pointed out the dissimilarities between the products which plaintiff produced for the commercial market and the products which it produced for the Government. The Trial Judge has noted, however, his reasons for considering Camel's commercial business to be a useful comparison and we find his conclusions on this matter persuasive.[37] Since it appears that there was greater competition in the commercial market than there was in the military tent market and since we find the similarity between Camel's commercial and renegotiable business to be at least as great as the similarity among the "all military tentmakers" group, we conclude that plaintiff's Comparison Y is entitled to relatively greater weight as a "starting point" than is Comparison X.

The Comparison Y standard may be depicted in the following fashion:[38]

Comparison Y

	Renegotiable		Commercial	
FY	Sales (000)	Profits	Sales (000)	Profits
1966	4,954	11.51%	2,684	4.3%
1967	7,117	13.20%	4,097	4.6%
1968	7,019	15.15%	5,861	6.6%

Ironically, because of the accounting adjustments made in Part I *supra*, neither one of the standards asserted by the plaintiff paints a picture entirely favorable to the plaintiff. About the only thing that can be said is that plaintiff's review year profits were not as high as some of its competitors in the military tent market. On the other hand, all those competitors with higher profits had them

[37] While the Trial Judge found Camel's renegotiable operations to be more complex than its commercial operations (and we take this into account in our "Character of Business" section, *infra*), he concluded that the profits of the same company, with the same management, and business acumen, competing against many of the same competitors in a market where "viable pricing mechanism" existed (the commercial market) would provide a valuable comparison against which to measure renegotiable profits. He bolstered this conclusion with the reasoning that a contractor should not be forced to earn less in dealing with the Government than it would if it refused Government contracts and dealt only in the commercial market.

[38] The value of GFP is in the renegotiable sales total here for reasons detailed *supra*.

renegotiated downward by the Board, so Camel cannot be heard to complain that it was singled out for special treatment.

The defendant contends that the only appropriate comparison must involve as a "starting point" the plaintiff's renegotiable business before the Vietnamese War caused a heat-up in the market. The Trial Judge rejected this so-called "base years" comparison (Comparison Z) out of hand, citing as a reason the many differences which he drew from the evidence presented between the plaintiff's base years' renegotiable operation and its review years' renegotiable operation. This summary rejection was an incorrect approach. The dissimilarity between Camel's base years and review years was not of a different magnitude than that between Camel's renegotiable and commercial business or than that among the various military tent manufacturers. The dissimilarity cited by the Trial Judge was an eminently sufficient reason to discount the weight accorded the comparison (as we discounted Comparisons X and Y), but it was certainly not enough to compel *total* rejection, particularly when the comparative standards offered by the plaintiff were as flawed and difficult to apply as were the ones offered here.

It is conceivable that a plaintiff, in presenting a *prima facie* case, could introduce such an airtight wealth of economic data, could introduce such a complete and detailed analysis of its change in economic conditions or its change in realized profits, that a comparative standard as inexact and dissimilar as the Trial Judge determined defendant's base years analysis to be could be discounted almost to the point of rejection. However, in the situation we face here, where plaintiff has itself offered only the skimpiest of economic data, and has offered no explanation of its own upon which we could draw, concerning its apparently healthy increase in profits between base years and review years, defendant's asserted comparison (Comparison Z) should be balanced and weighed with the rest. In our effort to reconstruct normality, every comparison we can make will be helpful, so long as we allow for the relative shortcomings of each.

The defendant's asserted comparison with GFP included, shows the following:

Comparison Z

		Total Sales	Renegotiable Sales	Renegotiable % Profit
Base Years	FY 1964	$ 3,499,693.00	$1,934,809.00	6.1 %
	FY 1965	4,591,568.00	2,503,541.00	4.7 %
Review Years	FY 1966	7,639,054.63	4,954,207.39	11.51%
	FY 1967	11,214,217.12	7,117,445.02	13.20%
	FY 1968	12,880,823.00	7,019,823.00	15.16%

Based on a relative balancing as described above, we find that this standard of comparison (Comparison Z) is entitled to weight greater than Comparison X, but not as great as Comparison Y. While we find Comparison Y to be the most useful standard for determining a "starting point" in the instant case, we do not dismiss totally either Comparison X or Comparison Z; instead, we retain these useful comparisons to assist us in reconstructing "normality."

Regardless of which standard is accepted as a starting point, however, it appears that the profits realized by plaintiff on its renegotiable work during the review years were relatively high and that the Board's determination or some determination of excessiveness may have been proper. It remains to be seen, though, by an analysis of the statutory factors, weighed according to the comparisons upon which they rely, whether plaintiff is entitled to any favorable consideration sufficient to allow retention of those profits which now may appear to be excessive.

B. *Statutory Factors:*

(1) *Efficiency:* This, the most emphasized of the statutory factors, is the one factor for which we are *directed* to allow the renegotiated contractor "favorable recognition," where merited.[39] It appears that the Government has overstated

[39] 50 U.S.C. App. § 1213(e)(1970). *See Mason & Hanger*, at 207 Ct.Cl. at 123, 518

its case a bit when it argues that the purpose of the Act is to ensure that "a contractor with experience and efficient equipment should pass on the benefits of its expertise to the government." As we have already stated, the purpose of the Act is to restore, to the greatest possible extent, a "normal" price/profit environment vis-a-vis the Government and a renegotiated contractor. One of the incentives for increasingly efficient operation on the part of a contractor is the expectation of increased profits resulting therefrom. Of course, if this increased efficiency is solely an efficiency of scale resulting from the increased volume of Government procurement, the Government would not be remiss in expecting a return benefit, in the form of price reductions, from the contractor. For this reason, the type of efficiency asserted by plaintiff or defendant assumes just as much importance as the fact that certain efficiencies existed.

In the case now before us, plaintiff has relied on its efficiency as deserving of favorable recognition. It resorts primarily to comparisons of efficiency between itself and other military tent manufacturers (Comparison X). The evidence presented by the plaintiff with regard to efficiency seemed calculated to demonstrate that plaintiff delivered on its military contracts in a precise fashion—on time and within specifications—to a greater extent than did its competitors.[40] The difficulty with this qualitative description of efficiency is, of course, the impossibility of assigning a precise, quantitative amount of money which plaintiff should be allowed to retain in "favorable recognition." Any numerical factor assigned must, therefore, be somewhat arbitrary and in keeping with the "broad brush" approach previously discussed.

F.2d 1352.

[40] The Trial Judge apparently utilized evidence in the form of reports to the Renegotiation Board, submitted on the plaintiff, in determining that plaintiff was, in fact, more efficient than its competitors in this regard. We see no reason to upset that determination, since these reports, submitted by Government employees in the regular course of their employment (and, perhaps, militating against the Government's interest) have previously been recognized by this court as acceptable evidence, particularly "where a more detailed comparison" was lacking. *Butkin*, 211 Ct.Cl. at 122, 544 F.2d at 506.

Because of this difficulty, defendant urges that no credit should be given for efficiency. Its expert witness in explaining how he had utilized base years (Comparison Z) to determine an exact amount of excessive profits, stated for the record his dissatisfaction with methodology which did not allow for specificity in assigning dollar values. While we may share his uneasiness with the inexactness of dollar values which must be assigned under some of the "qualitative" statutory factors, we may not ignore the dictates of Congress merely because exact dollar values may not be readily determinable.

The same expert witness testified that he had made no adjustments for statutory factors to his excessive profits determinations. He did, however, utilize certain exact cost data of various specific contracts (too limited, we think, for any overall conclusions) which showed that Camel's cost-per-tent figures had risen at a relatively quicker rate during the review years. His conclusion was that Camel had become relatively less efficient. The witness' failure adequately to respond to an attempt by the Trial Judge to determine whether other factors could have been responsible for the more rapid increase in costs,[41] indicated his inability to deal with items which could not be expressed in hard, cold, exact figures.

Yet difficulty of computation cannot be a ground for ignoring the vital statutory factor of efficiency. We agree with the Trial Judge that the witness did not give proper consideration to the relative efficiency factor in arriving at his conclusion and that plaintiff is entitled to "favorable

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[41] Plaintiff, for example, hired a second shift, *at Government request* and realized a significant increase in training and supervisory costs. Although this may have shown up in the figures used by defendant's expert, it is not really a fair comparison. Plaintiff may also have incurred additional costs in its efforts to meet contract and delivery specifications more regularly than other manufacturers. In addition, Mr. Katz revealed on cross examination that he was "speculating" on at least certain of the conclusions he attempted to draw from the cost figures concerning the "efficiency" of plaintiff.

recognition" (employing Comparison X - competitors)[42] as far as this factor is concerned.[43]

(2) *Net Worth (capital employment):* In this statutory factor, the defendant has clearly carried the day.[44] Based on its Comparison Z, defendant, through its expert witness, has quantitatively demonstrated that the profits earned by Camel on renegotiable business during the review years were far in excess of those earned during the base years[45] insofar as return on net worth and capital employed are concerned. The Government demonstrated how, in the instant case, this statutory factor had constituted the sum total of the methodology employed in arriving at the exact dollar amount of the profits deemed excessive. While we sympathize with the Government's desire (and the obvious desire of its expert witness) for exactness and specificity, and while we are grateful for whatever expert testimony we can get in these thorny problems, we believe that almost total reliance on one statutory factor—even though it be quantitative and highly useful—detracts from the flexibility so vital to achieving the purposes of this Act.

We do, however, find the quantitative evidence of profits returned as compared to net worth and capital employed, despite its severely restricted scope and the inherent limitations in Comparison Z, to be quite useful in our attempts to reconstruct normality in the case at hand. But net worth is just one of the factors used; it should not be

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[42] As can be seen, our analysis produces a sort of grid framework within which the statutory factors must be considered. If all six factors (assuming the category of "other factors" remains unused) were analyzed employing all three comparisons present in this case, a total of eighteen different credit/no credit threshold determinations would be possible. However, for purposes of brevity, we shall make determinations only on those factors and comparisons asserted or disputed by the parties.

[43] Camel, though not really asserting a base years comparison, introduced evidence which could tend to show that, through improvements in facilities and procedures, it actually increased its efficiency from the base years even though its operations became more complex and more difficult. While we do not deal with efficiency in a base years framework, this court has required an *increase* in demonstrated base years efficiency before allowing plaintiff credit toward an increase in base years profit. *See Mills Mfg. Corp.* v. *United States*, *post* at 558-65.

[44] Though plaintiff attempted to refute defendant's case on this factor through cross examination, it essentially offered no proof of its own.

[45] The difficulties inherent in considering the "base years" as normal have been discussed *supra*.

the only one. Defendant arrived at an average return on capital employed of 23.6% during the base years and then applied this figure to each of the review years to conclude that "reasonable" profits for each of those years would have been $203,490, $203,724, and $238,529, respectively.[46]

Defendant then performed similar computations[47] to arrive at an average 44.7%[48] return on net worth during the base years. Applying this figure to the review years, defendant's expert determined that reasonable profits would have been $186,041, $212,772, and $195,048, respectively.[49]

Thus, the total "reasonable profits" which defendant's expert witness would allow for three review years, is shown to be in the vicinity of $600,000. This is on total renegotiable sales for the three years of $19,091,475 (as determined in Part I, *supra*). If we were to accept this figure we would be allowing Camel a before tax profit of approximately 3% on its renegotiable sales, or as was astutely drawn out on cross examination of defendant's expert witness, an expected maximum retainable (after deducting for capital expenses necessary to undertake the Government contract) "increase in assets" of less than 1%.[50] Such figures are hardly likely to bring a flood of competitors into the market for Government contracts; they are below the relative percentage profits indicated in every one of the comparative standards, and they are roughly half those figures which the Board would have

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[46] As against actual profits on renegotiable sales during the review years (as determined in Part I *supra*) of $570,135, $939,733, and $1,064,000, respectively.

[47] In determining capital and net worth figures for FYs 1967 and 1968, the "excessive" profits for the previous FY(s) was first deducted out of the total.

[48] This figure was adjusted upward by defendant to 48.18% for FYs 1967 and 1968.

[49] *See* note 46, *supra*.

[50] Two additional facts of interest were also raised on cross examination of Mr. Katz, defendant's expert witness. First, in answering a question concerning the actual "exactness" of his figures, he admitted that for two FYs (years that he later decided not to use as a "base year") his figures showed that plaintiff's costs were 108% of sales and that plaintiff still made a 5% profit. This would appear to cast some doubt on the asserted accuracy of his system. Also, in a colloquy with the court, the witness testified that if, during his selected base years, plaintiff had shown only a 1% profit, then a 2% profit during the review years would be excessive. Defendant's expert is clearly long on reliance on "exact figures" but short on reasonableness which is the heart of renegotiation.

been willing to accept.[51] Nonetheless, in this *de novo* proceeding, such quantitative evidence is again invaluable in our search for "normality."[52]

Plaintiff virtually ignored and did not rely on the statutory factor of net worth. Defendant has carried its burden of proof and plaintiff is clearly entitled to no favorable recognition here.

(3) *Extent of Risk Assumed:* We agree with the Trial Judge that plaintiff has demonstrated that it incurred, in its renegotiable business, certain risks that it would not have faced had it not dealt with the Government. Major additional risks included the risk of sacrificing a developing commercial market, the risk of guaranteeing that its products would meet Government specifications which were far in excess of any commercial standard,[53] and the risks inherent in hiring and training another shift of workers solely at the request of the Government.

Primarily, it appears from the record that defendant's witness failed to accord plaintiff credit for the risk, which he admitted it assumed, because plaintiff had planned for it well and had, therefore, successfully weathered any risk it had assumed. Clearly, the total nonexistence of risk and the successful circumnavigation of existent risks are two entirely different matters. Defendant's risk argument is worthy of little credence.

While we do agree with Mr. Katz that a manufacturer employing GFP will suffer significantly fewer risks than will a manufacturer seeking out sources of supply on his own (and here we can take into account the difficult-to-quantify difference we perceive between a GFP recipient

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[51] One possible reason for this discrepancy is that Board regulations do not place "special emphasis" on net worth and return on capital whereas Mr. Katz testified that he relied "primarily" on that single statutory factor.

[52] While the presence of expert analysis of this quantitative evidence makes it far more probative than the bare figures rejected in *Blue Bell, Inc.* v. *United States*, 213 Ct.Cl. 442, 449, 556 F.2d 1118, 1124 (1977), a full comparative analysis of industry-wide figures could have made plaintiff's returns on capital and net worth far more determinative.

[53] This included the risk of possible non-acceptance by the Government of tents which failed to pass the "cup test," in which water was poured into a "cup" formed by indenting a tent along a seam to determine the watertightness of the seam. This "cup test" far exceeded any requirements of the commercial market.

and a raw materials purchaser),[54] we believe that Mr. Katz' basic testimony on this factor is of little assistance, and may well have been only retrospective in nature.

Thus, plaintiff has demonstrated that it is entitled to credit for risk assumed at least vis-a-vis the commercial market. We fail to see from the record, however, how acceptance of these risks would entitle plaintiff to any more favorable consideration than any other military tent producer who apparently would have been compelled to assume many of the same risks.

Therefore, if we employ Comparison Y (Commercial Business) plaintiff is entitled to credit for risk assumed; employing Comparison X (Competitors) there would be no such entitlement.

(4) *Nature and Extent of Contribution to the Defense Effort:* Under this statutory factor, we again have plaintiff pleading for credit because of apparent contributions and defendant's expert witness denying that credit because of his inability to assign a specific dollar value to it.

We agree with defendant's expert and the Trial Judge that Camel made several contributions to the defense effort, but we do not agree with defendant that these contributions were "minimal." The record clearly indicates that Camel instituted a new work shift, solely at Government request, when there was no otherwise compelling economic reason to do so. While an additional shift might ordinarily be seen as a method of increasing profits, this shift was begun in the face of a tight labor market in which new supervisory personnel were nearly impossible to obtain. The detrimental effects of this action on efficiency and risks assumed have been previously taken into account, but we cannot lose sight of the fact that the action was taken totally in an attempt to turn out more tents for the war effort.

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[54] Such a qualitative consideration of the benefit accorded a contractor by the receipt of GFP is the only possible approach on the record before us. This court has previously rejected attempts by Trial Judges to quantify this recognized benefit to the contractor as being "too speculative," *see Major Coat, supra*, 211 Ct.Cl. at 19-20, 543 F.2d at 107-08 or without "record evidence," *see Blue Bell, Inc.* v. *United States*, 213 Ct.Cl. 442, 451, 556 F.2d 1118, 1125 (1977).

In addition, there is evidence in the record to demonstrate that Camel assisted competitors and potential competitors alike—on every occasion in which it was requested to do so by the Government in order to increase the country's tent output to meet requirements. It conducted tours of the plant and exchanged technical information with representatives of these other firms and even went so far as to exchange information on scarce sources of component supply.[55] While such actions may also have been taken by certain of Camel's competitors in an effort to assist the Government in obtaining the greatest number of tents in the shortest possible time, it seems clear to us that, barring some desire to contribute to the defense effort, a manufacturer would not supply "aid and comfort" to a competitor, particularly when that competitor could very well be the one who subsequently engages in a life and death struggle for scarce post-emergency commercial business.

Further, both the addition of an extra shift and the provision of "aid and comfort" to competitors are contributions apparently made above and beyond those made during the base years.

We agree with the Trial Judge that defendant failed to carry its burden of proof against plaintiff's asserted contributions to the defense effort and that plaintiff is certainly entitled to credit under this factor (employing Comparisons X, Y or Z).

(5) *Character of Business:* The next statutory factor directs that we consider the character of the plaintiff's business "including source and nature of materials, complexity of manufacturing technique, character and extent of subcontracting, and rate of turn-over; . . ." Much of the evidence adduced at trial was apparently directed at this statutory factor. The Government introduced numerous witnesses intimately familiar with the military tent industry in an attempt to demonstrate that there was very little unique or noteworthy about Camel's operations, while plaintiff's witnesses testified at length concerning the

[55] This type of contribution has previously been given favorable consideration under this statutory factor in *Butkin*, 211 Ct.Cl. at 130-31, 544 F.2d at 510-11.

numerous, constantly increasing complexities which could be found in Camel's manufacturing processes, and the increasingly sophisticated products which it produced throughout the base years and review years.

Much of this testimony has already been considered in determining appropriate standards of comparison, *supra*. In attempting to determine whether specific credit is due for plaintiff's character of business, however, we are met with the fact that neither party adduced evidence concerning the "rate of turn-over" of products or inventory.

In addition, while it is evident that Camel did not subcontract any of its Government work, it is unclear how this fact should affect any of the comparisons since the degree of subcontracting present in the rest of the industry or in commercial business was never clearly brought to light. We cannot diminish a contractor's profits merely because he retains all the work, and all the responsibilities and obligations himself.[56]

Another sub-item under this statutory factor is the "source and nature of materials." We have already discussed in some detail the problems encountered in attempting adequately to reconcile the GFP situation with any kind of a "normal" business operation in which raw materials are purchased by the contractor. We believe it is evident that the risks assumed by the contractor are lessened somewhat in the GFP environment. This slight benefit of GFP to the contractor has already been accounted for by discounting slightly the credit otherwise due to Camel under the risk factor. No further consideration of the GFP issue is necessary here.

The final remaining sub-item concerns "complexity of manufacturing technique." Under this sub-item, the Trial Judge determined that plaintiff's product mix became more complex during the review years than it had been during the base years and that (in a quest for improved efficiency) plaintiff's manufacturing operations became more complex during the review years than they had been during the base years. Further, he also found that there was sufficient evidence in the record concerning the

[56] *See Butkin*, 211 Ct.Cl. at 128-29, 544 F.2d at 509-10.

relative complexity of manufacturing military tents and civilian tenting products to determine that Camel's renegotiable tenting operations were significantly more complex than its commercial operations. We agree.

We find that plaintiff has made a *prima facie* case for mitigating treatment under this statutory factor and that defendant has not carried its burden of proof. Therefore, plaintiff is entitled to credit for the complex character of its business if we employ Comparison Y (commercial business) or Comparison Z (base years).

(6) *Reasonableness of Costs and Profits:* In many respects, this statutory factor encompasses the ultimate issue which must be decided in a renegotiation case. We address the reasonableness of plaintiff's costs under the all-important efficiency factor and the reasonableness of profits is, in essence, discussed in the Appropriate Standards of Comparison section, supra. In an attempt to avoid further repetition of these items, we will discuss them in conjunction with our conclusions as to excessive profits.[57]

C. *Summary*

As can be seen from the discussion above (Part II), the plaintiff has made out its *prima facie* case in pleading several of the statutory factors. Since, according to *Lykes Bros.*, the Government bears the burden of proving both the fact and the amount of excessive profits, the Government must rebut plaintiff's *prima facie* case on these factors or Camel will be awarded credit.

The Government, in the present case, has made extensive use of expert testimony in its attempt to rebut the plaintiff's qualitative claims for credit under the statutory factors. While we find the analysis of this expert highly useful and helpful in our reconstruction of "normality," we are nonetheless struck by the inability of defendant's expert to weave the highly flexible and qualitative statutory factors analysis into his essentially quantitative financial assessment of which profits were excessive. Thus, although defendant made an excellent showing with regard

[57] There is a so-called seventh factor, "others," which has not been specifically addressed by either party. *See* note 4, *supra*.

to the quantitative statutory factor of net worth and capital employed, its response to such qualitative factors as risk assumed and contribution to the defense effort is insufficient to rebut plaintiff's claims for credit under those factors.

Plaintiff, on the other hand, has placed entirely too much emphasis on qualitative claims and has even failed to supply figures to back up those claims when such figures may have been available only in its own records. Thus, while plaintiff claims credit for efficiency, it adduces no evidence as to what extent its efficiency increased from base years to review years or to what quantitative degree its efficiency was better than that of its competitors. Admittedly, certain of the statutory factors—especially contribution to the defense effort—are simply not susceptible of numeric or quantitative proof. *However, where such evidence can be offered by the plaintiff, it should be offered by the plaintiff.* Generalities may be sufficient to demonstrate a *prima facie* entitlement to some credit under a statutory factor, but they simply cannot be accepted as demonstrating how much credit is due. Generalities are insufficient to prove a quantitative entitlement and, therefore, leave the court in the unenviable position of not only balancing plaintiff's generalities against defendant's specifics to determine whether defendant has carried its burden, but also of assigning some arbitrary value to plaintiff's generalities once it has been determined that defendant's proof was insufficient to carry its burden. A plaintiff who relies solely on general testimony as to efficiency, character of business, net worth, reasonableness of costs and profits, or extent of risk assumed, and who supplies no in depth economic analysis—which ties these factors together to explain a rise in profits—to assist in our reconstruction of normality, cannot be heard to complain that the credit which we have been compelled arbitrarily to attribute to a specific factor is monetarily insufficient.

In the case now before us, Camel relied heavily on revised accounting and general claims of credit under certain mitigating statutory factors in challenging the Board's determination that $1,375,000 of its renegotiable profits during the review years was excessive. When the

accounting is revised in accordance with part I of this opinion, Camel's profits exceed those of most of its competitors, those of its commercial business, and those of its base years by a considerable margin. Plaintiff's asserted credits, though general, thus assume utmost importance in our attempt to determine why these profits appear high.

Defendant attempts to move us in the other direction by arguing, based on a consideration of primarily one statutory factor, that the Board's $1,375,000 determination is too favorable to Camel and that, in fact, an excessive profits determination of $1,842,000 would still leave Camel with "reasonable" profits.

Much discussion has taken place in previous cases concerning the proper "starting point" for our application of various credits due plaintiff as a result of our "statutory factors" analysis. In *Major Coat*, we utilized the after-renegotiation profit figures of renegotiable firms manufacturing similar products, 211 Ct.Cl. at 42-44, 543 F.2d at 121–22; in *Butkin* we employed a base years' profit figure, 211 Ct.Cl at 121, 544 F.2d at 505; and, in *Blue Bell, Inc.* we began with a figure derived by allowing plaintiff the same percentage profit on renegotiable work as he received on his commercial work, 213 Ct.Cl. at 453, 556 F.2d at 1126. The most appropriate starting point, then, varies according to the facts of the specific case.

As we have previously discussed in our Appropriate Standards of Comparison section (Part II, A., *supra*), we perceive difficulties in all of the comparative standards asserted by both parties in the case at hand. However, for the reasons discussed therein we hold, following our precedent in *Blue Bell, Inc.* that the most acceptable starting point in the present case is one put forward by the plaintiff, namely Camel's percentage profits on its commercial business. Even after taking note of all the Government's asserted difficulties with this standard, it is superior to either of the others advanced.

The results of utilizing percentage of commercial profits as a starting point may be depicted as follows:

FY	% Commercial Profit	Renegotiable Sales [58]	"Starting Point" Renegotiable Profits
1966	4.3	$4,581,057	$196,985
1967	4.6	6,475,588	297,877
1968	6.6	6,376,684	420,861

As this chart demonstrates, if we were to allow Camel the same percentage return on its renegotiable business as it received on its commercial business, Camel's review years renegotiable profits would be $196,985, $297,877, and $420,861, respectively. This would mean, of course, that Camel's excessive profits would total $1,658,145,[59] an amount larger than the one originally assessed by the Board.[60]

Although we believe Comparison Y (Commercial Business) to be the most accurate starting point, this does not mean Comparisons X (Competitors) and Z (Base Years) may not be useful in producing a just result. Assuming, as a starting point, a renegotiable percentage profit for Camel equivalent to its percentage profit in its own commercial sales, Camel's profit picture in the other two comparisons would be depicted as follows:

Comparison X [61] *(Competitors)*

FY 1966	Plaintiff	Others	No. of Others
Sales range	$2.8 million	$1.4–2.8 million	(4)
Actual profit	20.50%	9.2%–34.4%	
After Renegotiation	8.2%*	9.2%–15.4%	

[58] These renegotiable sales figures differ from the totals determined in Part I because they reflect the diminution which must occur as renegotiable profits are reduced.

[59] Total profits of $2,573,868 minus total allowable profit of $915,723 = excessive profit of $1,658,145.

[60] This amount, $1,658,145, though more than the $1,375,000 determined excessive by the Board, is less than the $1,842,000 figure which the Government's expert witness urged as excessive profits.

[61] These figures are GFP-exclusive.

FY 1967	Plaintiff	Others	No. of Others
Sales range	$3.8 million	$1.1–$6.7 million	(7)
Actual profit	24.68%	6.9%–39.1%	
After Renegotiation	9.4%*	6.9%–15.4%	

FY 1968	Plaintiff	Others	No. of Others
Sales range	$3.8 million	$1.1–$5.4 million	(11)
Actual profit	28.01%	7.6%–50.0%	
After Renegotiation	13.3%*	6.8%–15.6%	

* These figures for Camel would, of course, be after action by this court and the diminution of sales discussed in note 58, *supra*.

Comparison Z (Base Years)

		Total Sales [62]	Renegotiable Sales	Renegotiable % Profit
Base Years	FY 1964	$ 3,499,693	$1,934,809	6.1%
	FY 1965	4,591,568	2,503,541	4.7%
Review Years	FY 1966	7,265,905	4,581,057	4.3%
	FY 1967	10,572,360	6,475,588	4.6%
	FY 1968	12,237,684	6,376,684	6.6%

From these additional comparisons, it can be seen that percentage commercial profits yield a "ballpark" starting point for renegotiable profits. While Comparison Z would appear to demonstrate that allowing Camel to retain only the same percentage profit on its renegotiable sales as it earned on its commercial sales would keep Camel within the same profit range as its own base years, Comparison X shows that restricting Camel to a commercial percentage profit return on its renegotiable sales would place Camel

[62] *See* note 58, *supra*.

on the lower fringe of the military tent manufacturers group insofar as renegotiable profits are concerned. In fact, retention of only this much profit would place Camel well below the approximately 15.5% profit level which the Board appears to have established as a reasonable limit for this group.

It must be remembered, however, that this commercial percentage profit represents merely a starting point and that it must be adjusted according to our analysis of the mitigating statutory factors. From this previous analysis, we determined that plaintiff was entitled to credit (as against his commercial business) in the areas of risk assumed, contributions to the defense effort, and character of business.

In previous cases, this court has fashioned credit for statutory factors in a variety of ways. We have utilized percentage allowances, *see Blue Bell, Inc.* 213 Ct.Cl. at 453, 556 F.2d at 1126; *see also Mason & Hanger,* 207 Ct.Cl. at 146, 518 F.2d at 1365; assignment of dollar figures drawn from the record to the "value added" under each statutory factor, *see Butkin,* 211 Ct.Cl. at 128–29, 544 F.2d at 509–10; and fractional allowances of actual profit which place plaintiffs in a proper relative position on an industry-wide basis, *see Major Coat,* 211 Ct.Cl. at 47-48, 543 F.2d at 123–24. The court has shown an uneasiness in utilizing such devices, *see, e.g., Major Coat,* 211 Ct.Cl. at 48, 543 F.2d at 124, but has generally decided that a broad brush approach is appropriate so long as the evidence in the record is sufficient to permit a responsible judgmental adjustment in determining a reasonable profit for the renegotiated contractor. *Id.* While we have previously pointed out the relative shortcomings of the record here, we believe that sufficient evidence does exist to make such adjustments.

Accordingly, as a result of our deliberations on the facts presented in the record, to create "normality" we determine that, as a matter of judgment, plaintiff is entitled to a profit adjustment of an additional 4 percent of its renegotiable sales. This is over and above the percentage earned on its commercial sales, in order to compensate Camel for credit due under the statutory factors of risk assumed, contributions to the defense effort, and character

of business as detailed above. The 4 percent credit will have the following results.

FY	% Commercial Profit	% Commercial Profit + 4% Renegotiable Credit	Renegotiable Sales [63]	Renegotiable Profit after Credit
1966	4.3	8.3	$4,780,885	$396,813
1967	4.6	8.6	6,758,984	581,273
1968	6.6	10.6	6,661,994	706,171

Thus, after allowing Camel credit under the mitigating statutory factors, as directed by the Act, we determine that Camel's reasonable profits for the three review years totaled $396,813, $581,273, and $706,171, respectively, and that its excessive profits total $889,611.[64]

This resolution of the dollar profits not only places Camel in its proper position relative to its own commercial business, but it also appears, interestingly, to approximate "normality" with regard to each of the other Comparisons. These results may be depicted as follows:

Comparison X [65] *(Competitors)*

FY 1966	Plaintiff	Others	No. of Others
Sales range	$2.8 million	$1.4–$2.8 million	(4)
Actual profit	20.50%	9.2%–34.4%	
After Renegotiation	15.2%	9.2%–15.4%	

[63] *See* note 58, *supra.*

[64] Total profits of $2,573,868 minus total allowable profits of $1,684,257 = excessive profits of $889,611.

[65] This data is on a GFP exclusive basis as obtained from the Board.

FY 1967	Plaintiff	Others	No. of Others
Sales range	$3.8 million	$1.1–$6.7 million	(7)
Actual profit	24.68%	6.9%–39.1%	
After Renegotiation	16.8%	6.9%–15.4%	

FY 1968	Plaintiff	Others	No. of Others
Sales range	$3.8 million	$1.1–$5.4 million	(11)
Actual profit	28.01%	7.6%–50.0%	
After Renegotiation	20.5%	6.8%–15.6%	

Comparison Z (Base Years)

		Total Sales [66]	Renegotiable Sales	Renegotiable % Profit
Base Years	FY 1964	$ 3,499,693	$1,934,809	6.1%
	FY 1965	4,591,568	2,503,541	4.7%
Review Years	FY 1966	7,465,732	4,780,885	8.3%
	FY 1967	10,855,756	6,758,984	8.6%
	FY 1968	12,522,994	6,661,994	10.6%

Looking at these two comparisons in our effort to insure as close an approach as possible to "normality," we find that, in Comparison X, Camel's combined average profit rate for the review years was 17.7%, 2.2% above the 15.5% generally accepted as "normal" for this industry by the Board during these years. However, as we have previously stated, we do not know the specifics of the Board's deliberations and do not, therefore, know the basis on

[66] Review year sales reflect diminution of profits as in note 58.

which the Board awarded, or did not award, credit. We do know, however, that we are directed by the Act to accord Camel favorable recognition for efficiency. We believe a 2.2% premium for Camel's efficiency vis-a-vis other manufacturers (in its field)[67] is not out of line as a means of according this favorable recognition.

In addition, from Comparison Z we can see that Camel is accorded an increase in profits over the base years. The evidence demonstrated that plaintiff's contributions to the defense effort, and changes in its character of business entitled it to credit in relation to its base years profit. We believe the increases in profit demonstrated by Comparison Z represent proper credit under these factors.

In short, we hold that the "4% solution" outlined above recreates, to the greatest possible extent, a "normal" business environment[68] and properly rewards plaintiff in the circumstances of these cases, for certain increased efforts deemed important by Congress.

Finally, in Part I, we hold that plaintiff has failed to carry its burden of proof in the resolution of disputed accounting data and that, with the exception of the exclusion of GFP, defendant has produced the correct accounting in this case. In Part II, we hold that the evidence in the record (including those comparisons asserted by the plaintiff) demonstrates the excessive nature of plaintiff's profits, but that defendant, with the exception of the single statutory factor of net worth, has failed to prove that the amount of plaintiff's excessive profits was as great as defendant claimed.

CONCLUSION OF LAW

Accordingly, judgment is hereby entered for the United States on its counterclaims for each of the review years in the amounts of $173,322, $358,460, and $357,829, respectively, (a total of $889,611) with each of these amounts to

[67] *See* our discussion under the "efficiency" section, *supra* at 500–01.

[68] With regard to our assessment of "normality," Camel's own Annual Report for the FY ending September 30, 1973, informed its stockholders that, in the opinion of counsel, these renegotiation actions before the Court of Claims could result in Camel's refunding to the Government excessive profits possibly amounting to $610,000 (less applicable tax credits).

be decreased by appropriate tax credits and increased by interest as allowed by law.

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571 F.2d 11

WINTER & HIRSCH, INC. v. THE UNITED STATES

[No. 206–75. Decided February 22, 1978. Plaintiff's motion for rehearing to alter judgment denied April 4, 1978.]

ON DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT

Taxes; income tax; deductions; reserve for bad debts; addition to reserve; bad debts from prior years.—Plaintiff was in the business of making consumer loans, using the reserve for bad debts method to compute its deduction for bad debts. Plaintiff claims it is entitled to an additional deduction in its fiscal year 1963 as a reasonable addition to its bad debt reserve because of unaccounted debts which admittedly became worthless in prior taxable years. It is *held* that an admittedly worthless debt must be accounted for by a reserve method taxpayer in computing its bad debt deduction in the year in which it became worthless. Defendant's motion for partial summary judgment is granted, plaintiff's claims for refund for taxable years 1960, 1961 and 1962 are denied, and the petition is dismissed.

Taxes; income tax; deductions; bad debts; reserve for bad debts; addition to reserve; bad debts from prior years.

[1] A reserve method taxpayer may not subtract unaccounted debts which became worthless in a prior taxable year from its bad debt reserve in computing its bad debt deduction ("reasonable addition") for a subsequent unrelated year.

Internal Revenue ⚖674

Roger B. Harris, attorney of record, for plaintiff. *David V. Kahn, Howard Friedman, John F. Prusiecki,* and *Altheimer & Gray,* of counsel.

Kenneth R. Boiarsky, with whom was *Assistant Attorney General M. Carr Ferguson,* for defendant. *Theodore D. Peyser,* of counsel.

Before DAVIS, KASHIWA, and BENNETT, *Judges.*

KASHIWA, *Judge,* delivered the opinion of the court:

This tax refund suit is before the court on defendant's motion for partial summary judgment. Plaintiff claims it is entitled to an additional deduction in fiscal year 1963 of $661,386.28 as a reasonable addition to its bad debts reserve on account of debts which admittedly became worthless in prior taxable years. Defendant maintains plaintiff is not so entitled. After careful consideration of the briefs and oral arguments, we grant defendant's motion for partial summary judgment.

The plaintiff is a corporation which ceased doing active business in 1970. Prior to that time, plaintiff was in the business of making consumer loans, primarily to finance consumer purchases of automobiles. At all relevant times plaintiff filed its federal income tax returns on the basis of a fiscal year ending August 31 and used the reserve for bad debts method to compute its deduction for bad debts.

At some time after 1969 plaintiff discovered that certain debts owed to it, which had become worthless in periods prior to the 1963 taxable year and which had been charged off in its underlying records during those periods, had not been taken into account for tax purposes either as deductions or in computing taxpayer's bad debts reserve. These debts, amounting to at least $661,386.28,[1] were not taken into account for tax purposes by reason of a scheme to defraud which had been perpetrated upon plaintiff by its key officers from 1957 to 1969 with the active cooperation of the certified public accountants retained during that time.

On October 15, 1970, taxpayer timely filed claims for refund for its 1960, 1961, and 1962 taxable years on the ground that it had overpaid its taxes for those years as a result of a net operating loss carryback from its 1963 taxable year. The alleged 1963 net operating loss resulted from an increased bad debts deduction to which taxpayer claims it is entitled. Taxpayer asserts that its bad debt deduction for 1963 should be increased by $661,386.28, from $671,541.51 to $1,332,927.79, as a result of decreasing

[1] Although plaintiff's original petition alleged a figure in excess of $661,386.28, we will limit our discussion to $661,386.28 for if plaintiff can deduct this additional amount in fiscal 1963, the 1963 net operating loss carryback will be sufficient to wipe out plaintiff's entire income tax liabilities for fiscal years 1960, 1961, and 1962.

its ending bad debts reserve balance for 1962 by $661,386.28 for the debts which admittedly became worthless in taxable years prior to fiscal 1963.

The defendant agrees that plaintiff's proper ending bad debts reserve balance for 1963 is $892,079.15. Defendant also agrees that $624,194.73 of plaintiff's receivables became worthless during fiscal 1963. However, defendant does not agree that plaintiff's 1962 ending bad debts reserve balance was reduced from $844,732.37 to $183,346.09 because of the $661,386.28 of receivables which had become worthless in prior years. Therefore, the Commissioner failed to act upon plaintiff's refund claims.

The issue for our decision is whether a taxpayer using the reserve method of computing its bad debts deduction can subtract debts, which admittedly became worthless in prior taxable years (but which were not accounted for in the prior years), from the bad debts reserve in computing its current year's bad debt deduction. We hold a taxpayer cannot do so.

Internal Revenue Code[2] § 166 authorizes a deduction for bad debts. Two mutually exclusive methods of computing the deduction are allowed by the Code: the direct charge off method[3] and the reserve method.[4] Under the direct charge off method the taxpayer is authorized to deduct from gross income the amount of receivables which become worthless during the taxable year for which the return is being filed. If a debt becomes worthless during a year, the related deduction must be taken *only* on that year's return and not for some later year. I.R.C. § 166(a).

The reserve method authorizes the taxpayer to deduct from gross income, in lieu of the amount of receivables which became worthless during the taxable year, a "reasonable addition" to the reserve for bad debts. I.R.C. § 166(c). The amount of the "reasonable addition" to the bad debts reserve in any taxable year will depend upon the three elements which compose the reserve method formula: the prior taxable year's ending bad debts reserve balance;

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[2] Hereinafter all Internal Revenue Code sections will be cited I.R.C. and will be to the 1954 Code as amended, unless otherwise stated.

[3] I.R.C. § 166(a).

[4] I.R.C. § 166(c).

the amount of receivables which become worthless during the current taxable year; and the current taxable year's ending bad debts reserve balance. The prior year's ending bad debts reserve balance is determined by looking at the total receivables on hand at the end of the prior taxable year and estimating, upon the basis of past experience or an evaluation of the receivables, the amount of them which will eventually become worthless. This estimated amount becomes the prior year's bad debts reserve balance. As receivables actually become worthless during the succeeding taxable year, they are subtracted from the prior year's ending bad debts reserve balance, which lowers the bad debts reserve balance. The current year's ending bad debts reserve balance is computed in the same fashion as the prior year's ending bad debts reserve balance, except it is based upon the total amount of receivables on hand at the end of the current taxable year. To compute the "reasonable addition" (deduction) for the current taxable year, one subtracts the prior taxable year's ending bad debts reserve balance, after it has been reduced by the amount of receivables which actually became worthless during the current taxable year, from the current taxable year's ending bad debts reserve balance. *See Smith Electric Co.* v. *United States*, 198 Ct. Cl. 644, 646, 461 F. 2d 790, 791 (1972); Mertens, *Law of Federal Income Taxation*, § 30.69 *et seq.* (Doheny Rev. 1975).

In this case the parties differ over the prior taxable year's (fiscal 1962) ending bad debts reserve balance. Plaintiff contends it is $183,346.09. This is so according to plaintiff because the $844,732.37 balance reflected on its accounting records had been automatically reduced by the $661,386.28 of receivables which became worthless in the prior tax years and were not subtracted from the bad debts reserve account. In making this contention plaintiff specifically states that there is no accounting or charge off required on the taxpayer's books before the prior taxable year's bad debts reserve is automatically decreased by worthless debts.

Defendant maintains plaintiff's fiscal 1962 bad debts reserve balance was not automatically reduced by the $661,386.28 of prior years' worthless receivables, but

instead remained at $844,732.37. We agree with the defendant. In doing so we add that we agree with the plaintiff's contention that there is presently no charge off requirement in determining whether a debt has become worthless during a certain tax year.[5] I.R.C. § 166(a)(1). However, this is not the issue before us in this case for the parties have agreed that the $661,386.28 of worthless receivables became worthless in taxable years other than fiscal 1963. The issue in this case is in which taxable year must an admittedly worthless debt be accounted for in computing the bad debts deduction under the reserve method - the year in which the debt became worthless or a later year.[6]

We hold that an admittedly worthless receivable must be accounted for by the taxpayer in computing its bad debt deduction in the year in which it became worthless. This is so regardless of whether the taxpayer is on the reserve method or the direct charge off method of computing its bad debts deduction. To hold otherwise would be an open invitation to reserve method taxpayers to distort their taxable income. Such taxpayers could distort their taxable income by manipulating their bad debts deduction. They could make an inadequate addition to the reserve for bad debts in one year and an excessive addition in some future high income year, when the worthless debts from prior taxable years were finally charged off against the reserve for bad debts. *Fibre Yarn Co.* v. *Commissioner*, 10 BTA 479, 481 (1928); Mertens, *Law of Federal Income Taxation*, § 30.73 (Doheny Rev. 1975). Further, to hold differently in this case would allow this plaintiff, by means of the net operating loss provision, I.R.C. § 172, to subvert the statute of limitations on refunds, I.R.C. § 6511(d), and open up closed tax years.[7]

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[5] There is still a charge off requirement in the case of partially worthless debt. I.R.C. § 166(a)(2).

[6] In holding this to be the real issue for decision, we reject plaintiff's "automatic reduction" of the prior year's bad debts reserve balance analysis. The reason is there is no substantive value in such an analysis for the effect is the same as if plaintiff had charged the worthless receivables from prior years to the bad debts reserve during the 1963 taxable year. The end result is identical; plaintiff would get a large increase in its fiscal 1963 bad debts deduction.

[7] Plaintiff filed the claim for refund in this case October 15, 1970. At that time refund claims for plaintiff's fiscal 1960, 1961, and 1962 tax years were barred by the

Conclusion

The rationale behind our decision in *Smith Electric, supra,* supports our decision. The question before this court in *Smith Electric* was whether the special seven-year statute of limitations in I.R.C. § 6511(d) applied to taxpayers on the reserve method as well as those on the direct charge off method. There we analyzed and compared the operation of the direct charge off method and the reserve method. We found that

> * * * Both taxpayers using the direct charge-off method and those utilizing the reserve method must charge-off specific debts in the year they become worthless. * * *
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> * * * * *
>
> * * * [The taxpayer] cannot make this adjustment in some later year. [The taxpayer] is permitted to charge worthless accounts against the reserve *only* in the year they become worthless. [Emphasis in original text.] [*Smith Electric Co., supra* at 648–649, 461 F. 2d at 793.]

Because both methods required the worthless receivable be charged off in the year it became worthless, we concluded in *Smith Electric* that the same statute of limitations was applicable to both methods. This was necessarily so in our opinion because the same risk of charging off a worthless debt in a year other than the year it actually became worthless was inherent in both methods.

CONCLUSION

Plaintiff, a reserve method taxpayer, cannot account for the $661,386.28 of worthless receivables in computing its fiscal 1963 bad debts deduction, because the receivables admittedly became worthless in prior taxable years. Therefore, we grant defendant's motion for partial summary judgment. Since this is the sole ground upon which plaintiff relies in seeking a refund for taxable years 1960,

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statute of limitations. I.R.C. § 6511(d)(1). The only way in which the plaintiff could obtain a refund of taxes paid in those years was by claiming a large bad debts deduction in fiscal 1963. This in turn generated a net operating loss which plaintiff could carry back under the net operating loss provision, I.R.C. § 172, to fiscal years 1960, 1961, and 1962 and the exception to the statute of limitations for net operating loss carrybacks. I.R.C. § 6511(d)(1) and (2).

1961, and 1962, we deny the claims for refund for those taxable years and dismiss the petition.

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571 F.2d 14

JOSEPH T. ALLEN v. THE UNITED STATES

[No. 355–76. Decided February 22, 1978. Defendant's suggestion for rehearing *en banc* and motion for rehearing denied May 26, 1978]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

National Guard technician; entitlement to disability retirement benefits; standard for determining; military v. civilian.—Plaintiff, a former technician in the Texas Air National Guard, seeks disability retirement benefits after being involuntarily separated in 1974. In his civilian employment plaintiff maintained National Guard aircraft, missiles and support equipment. National Guard technicians are required to be employees of the National Guard on a full-time basis, they must meet all mental and physical standards prescribed by the military, they are subject to the terms of 32 U.S.C. § 709(e)(1), and they are required to be physically fit for world-wide service. Plaintiff was determined to be physically unfit for world-wide service in the military by reason of insulin-dependent, uncontrolled diabetes; he was informed that he could apply for a disability retirement annuity under 5 U.S.C. § 8331(1) or a discontinued service annuity under 5 U.S.C. § 8336(d). Plaintiff's administrative claim for a disability annuity under 5 U.S.C. §§ 8331(1)(A) and 2105 was denied because the evidence failed to establish a disability severe enough to prevent useful, efficient and safe performance of the civilian duties of his position. Upon separation, plaintiff applied for a discontinued service annuity which was allowed retroactive to the date his employment with the Guard was terminated. The present suit was then filed. It is *held* that the findings of the Civil Service Commission Bureau of Retirement, Insurance and Occupational Health and of the Federal Employees Appeal Authority that plaintiff is not totally disabled for purposes of 5 U.S.C. § 8331 are legally erroneous. In light of the National Guard Technicians Act, the Commission must defer to the military judgment in this regard, and in the judgment of the military plaintiff is physically disabled for technician employment. Plaintiff should be eligible for a disability annuity. Plaintiff's motion for summary judgment is granted, defendant's cross-motion is denied, and it is ordered that plaintiff's Civil Service Commission records be corrected to show that he has been

retired for physical disability since May 24, 1975. Judgment is entered for plaintiff, the amount of recovery to be determined under Rule 131(c).

Civilian pay; Civil Service retirement; disability retirement; disability determination of Civil Service Commission; finality of determinations.

[1] Since 5 U.S.C. 8347 provides that decisions of the Civil Service Commission regarding questions of disability are final and conclusive and are not subject to review, the court cannot disturb a disability determination unless there has been substantial departure from important procedural rights, misconstruction of the governing legislation or some like error going to the heart of the administrative determination.

Officers ⚖101

Civilian pay; Civil Service retirement; disability retirement; National Guard technician.

[2] In view of the dual status nature of the position of National Guard technician, i.e. contemporaneous membership in the Guard as a condition of employment as a technician, prompt removal from employment upon separation from the Guard, and a composite of inseparable, simultaneous military and civilian duties, such duties constitute a single job for purposes of determining disability and resultant retirement benefits.

Militia ⚖12

Military pay; National Guard; technicians; disability retirement; standard for determining.

[3] In view of 32 U.S.C. § 709(e)(5) providing that the National Guard's determination of physical disability of a technician is within the adjutant general's unreviewable discretion, of settled law respecting reviewability of military determinations of physical fitness and of the inseparability of the military and civilian aspects of a technician's job, the military standard for determining physical fitness for service should prevail over the civilian standard where the military and civilian tribunals are in disagreement.

Militia ⚖12

Mark D. Roth, attorney of record for plaintiff. *L. M. Pellerzi*, of counsel.

Stephen G. Anderson, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before COWEN, *Senior Judge*, NICHOLS and BENNETT, *Judges*.

NICHOLS, *Judge*, delivered the opinion of the court:

This civilian pay case is before the court on cross-motions for summary judgment. Plaintiff, who served from 1956 through 1974 as a production controller technician in the Texas Air National Guard, is seeking disability retirement benefits, after being terminated because physically unfit for world-wide service in the military.

The controversy over plaintiff's eligibility to receive federal civilian disability benefits arises out of the peculiar nature of the technician position. Technicians like plaintiff are full-time employees of the National Guard who, under the National Guard Technicians Act of 1968, 32 U.S.C. § 709, are required concurrently to be members of the National Guard. As such, technicians must meet all the mental and physical standards, as well as professional qualifications, prescribed by the military departments. *See* H. Rep. No. 1823, 90th Cong., 2d Sess. (1968), *reprinted in* 3 U.S. CODE CONG. & AD. NEWS 3318, 3319 (1968). The House Report described the technician program as follows:

> [T]echnicians will serve concurrently in three different ways: (a) Perform fulltime civilian work in their units; (b) perform military training and duty in their units; and (c) be available to enter active Federal service at any time their units are called.

These dual status technicians are also subject to the terms of 32 U.S.C. § 709(e)(1), which provides:

> (e) Notwithstanding any other provision of law * * *
>
> (1) a technician who is employed in a position in which National Guard membership is required as a condition of employment and who is separated from the National Guard or ceases to hold the military grade specified for his position by the Secretary concerned shall be promptly separated from his technician employment by the adjutant general of the jurisdiction concerned;

In his civilian employment as a production controller, plaintiff's duties involved maintenance of aircraft, missiles, and support equipment owned by the National Guard or assigned to it by the United States Air Force. Plaintiff held the rank of Chief Master Sergeant in the National Guard, was part of the chain of command in his unit, subject to military discipline, and required to be physically fit to go

into combat and to accompany his unit anywhere it might be called.

Plaintiff has an insulin-dependent, uncontrolled diabetes mellitus condition which requires him to maintain a strict diet and schedule. This condition has existed for over twenty years, and has been treated by plaintiff's private physician, Dr. Monte. In September of 1974, after Dr. Monte, at plaintiff's request, sent a letter of certification of health mentioning plaintiff's condition, Allen was examined by Dr. Frank A. Lang, a Texas Air National Guard physician. Dr. Lang confirmed the diagnosis of diabetes mellitus and advised Allen that he no longer qualified for world-wide and general military service because he would not be able to adhere to a strict schedule and diet while traveling abroad. It might be noted that in any event diabetes mellitus is a medical condition which disqualifies individuals for service under Air Force Regulation AFM 1–60–1C.

In a letter received on November 29, 1974, plaintiff was formally notified that his loss of membership in the Texas Air National Guard would be effective as of November 30, 1974. He was also advised that pursuant to 32 U.S.C. § 709(e)(1) his employment as a National Guard technician would be terminated no earlier than 30 days after the date of receipt of the letter. In addition, plaintiff was informed in this letter that he had the option of applying for a disability retirement annuity under 5 U.S.C. § 8331(1), or, alternatively, for a discontinued service annuity under 5 U.S.C. § 8336(d).

Plaintiff elected to apply for a disability annuity, under the Federal Retirement Program, 5 U.S.C. §§ 8331 (1)(A) and 2105, and, on December 3, 1974, filed a claim with the Bureau of Retirement, Insurance and Occupational Health (BRIOH), of the United States Civil Service Commission. In support of his application, plaintiff submitted a Physician's Statement completed by Dr. Monte, who indicated his belief that plaintiff was disabled for his former position of production controller. In addition to diabetes mellitus, Dr. Monte also diagnosed Type II hyperdipoproteinemia, early macular degeneration and early diabetic retinapathy, osteoarthritis of spine and shoulder, and reflex esophagitis.

Dr. Monte further found that plaintiff experienced great difficulty in maintaining his schedule when traveling abroad.

BRIOH also had before it a Supervisor's Statement completed by Harold H. Ponder, who noted that plaintiff was fully capable of performing all of his civilian duties as defined by the job description for production controller.

In a decision dated January 8, 1975, BRIOH denied plaintiff's claim because "the evidence failed to establish a disability severe enough to prevent useful, efficient and safe performance of the essential duties of the position from which appellant was seeking retirement." Plaintiff's notice of disallowance was dated January 14, 1975. He appealed to the Dallas Field Office of the Federal Employees Appeal Authority (FEAA), on January 21, 1975.

The FEAA held a hearing on April 7, 1975, at which testimony was offered by three witnesses: plaintiff, Colonel Ponder, and Sergeant Houston Landry, also a production controller. Plaintiff testified that his civilian and military positions were substantially similar, if not totally identical, and that he had great difficulty maintaining his diet and schedule while abroad. Plaintiff also stated that world-wide travel, as part of both civilian and military duties, came up approximately every 12 weeks. The other two witnesses both testified that the civilian and military aspects of the technician job were identical.

On May 20, 1975, the FEAA issued an opinion affirming the BRIOH determination that plaintiff was not severely enough disabled to prevent efficient performance of his civilian duties. The FEAA concluded that on the basis of the evidence before it, plaintiff was not totally disabled within the meaning of the relevant retirement statute and regulations.

Plaintiff was placed on leave without pay status on December 30, 1974, pending resolution of his claim for disability retirement pay. On May 24, 1975, plaintiff was finally separated from his civilian position.

Thereafter, plaintiff applied for a discontinued service annuity. His claim was allowed retroactive to the date his employment with the Guard was terminated, and he has received about $428 per month since May 24, 1975. On

August 26, 1976, plaintiff filed a petition in this court seeking both prospective relief and the accumulated difference between the disability annuity and the discontinued service annuity.

The question before the court is whether, under the relevant Civil Service statutes, 5 U.S.C. §§ 8331(6), 8337, and the National Guard Technicians Act, *supra*, plaintiff is entitled to a disability retirement annuity notwithstanding the contrary determination of the Civil Service Commission.

Section 8331(6) defines "disabled" and "disability" as follows:

> "disabled" and "disability" mean totally disabled or total disability, respectively, for useful and efficient service in the grade or class of position last occupied by the employee or Member because of disease or injury not due to vicious habits, intemperance, or willful misconduct on his part within 5 years before becoming so disabled;

Section 8337 provides:

> (a) An employee who completes 5 years of civilian service and is found by the Civil Service Commission to have become disabled shall be retired on his own application or on application by his agency. * * * An annuity authorized by this section is computed under section 8339 [Computation of annuity] of this title.

As we have already stated, the Civil Service Commission, or, more specifically, BRIOH and FEAA, determined that plaintiff was not "totally disabled" for purposes of his civilian employment.

The scope of review of the Commission's disability determinations is narrow. Although section 8347 of 5 U.S.C. provides that decisions of the Civil Service Commission regarding questions of disability are "final and conclusive and are not subject to review," this court has construed this to mean not that the Commission's disability determinations are sacrosanct, but rather that they cannot be disturbed unless "there has been a substantial departure from important procedural rights, a misconstruction of the governing legislation, or some like error 'going to the heart of the administrative determination.' " *Gaines* v.

United States, 158 Ct. Cl. 497, 502, *cert. denied*, 371 U.S. 936 (1962). *See, e.g., McFarland* v. *United States*, 207 Ct. Cl. 38, 46–47, 517 F.2d 938, 942–43 (1975), *cert. denied*, 423 U.S. 1049 (1976); *Scroggins* v. *United States*, 184 Ct. Cl. 530, 533–34, 397 F.2d 295, 297, *cert. denied*, 393 U.S. 952 (1968); *McGlasson* v. *United States*, 184 Ct. Cl. 542, 549, 397 F.2d 303, 307 (1968). We find that in denying plaintiff's claim, the Commission failed to take into account the effect of the National Guard Technicians Act of 1968. We therefore set aside its findings.

From the record it appears that little or no consideration was given by either BRIOH or the FEAA to the dual status nature of the technician job. Perhaps a brief discussion of the 1968 Act, and its legislative history would clarify the proper characterization of this job. The 1968 Act made contemporaneous membership in the National Guard a condition of employment as a technician. 32 U.S.C. § 709(b). Moreover, any technician who is separated from the National Guard for any reason must be promptly removed from his or her employment altogether. 32 U.S.C. § 709(e)(1). The dominant purpose of the Act, however, was to bring technicians under the umbrella of the federal retirement and fringe benefit programs. This was to promote national uniformity in such benefits among technicians, who previously had been covered by a variety of state programs. Technicians are now covered under the Civil Service system, rather than by state or, alternatively, career military programs.

The legislative history accompanying the Act indicates that Congress contemplated that the single technician position would entail a composite of inseparable, simultaneous military and civilian duties. *See* H. Rep. No. 1823, 90th Cong., 2d Sess. (1968). This interpretation of Congressional intent is amply supported by the statutory requirement that any technician failing to retain National Guard enrollment be completely severed from his job. Under the Act, the civilian duties cannot stand alone to comprise a job distinct from the military activities. Section 709(e)(1). *See also Tennessee* v. *Dunlap*, 426 U.S. 312 (1976); *Chaudoin* v. *Atkinson*, 494 F.2d 1323 (3d Cir. 1974). As a result of this dual qualification aspect, technicians, although by statute

eligible only for civil service retirement benefits, may be forced to retire either by military authorities, or by supervisors of their civilian duties. The continued employment of technicians is subject not only to civil service requirements, but also to military regulations. In view of this, we find that the civilian and military duties imposed on plaintiff constitute a single job for purposes of determining disability and resultant retirement benefits.

It is here that defendant's arguments must fail. Defendant argues that eligibility for disability retirement is predicated exclusively upon a finding by the Civil Service Commission that plaintiff is totally disabled to perform his civilian duties. *Ergo,* because plaintiff has not been determined totally disabled for purposes of the civilian aspects of his position, he cannot qualify for a disability annuity under 5 U.S.C. § 8337. In short, defendant takes the position that plaintiff's physical disqualification for military duty disqualifies him for his civilian position by operation of law and not by reason of his "total" physical disability to perform his duties. Again, this ignores the inseparability of the military and civilian aspects of the job. Plaintiff has been involuntarily retired by reason of his physical condition. Moreover, the National Guard's determination of physical disability is by statute within the adjutant general's unreviewable discretion. 32 U.S.C. § 709(e)(5). Here, where the military officials and civilian tribunals have taken somewhat conflicting positions, plaintiff is caught in between, declared ineligible both for employment as a technician and for disability retirement. It would seem only fair that there be a single standard in determining physical fitness for employment as a technician. In light of section 709(e) and settled law respecting reviewability of military determinations, it is preferable that the military standard prevail when there is disagreement. *Cf. Mindes* v. *Seaman,* 453 F.2d 197, 199 (5th Cir. 1971) (judicial reluctance to review military decisions); *Turner* v. *Egan,* 358 F.Supp. 560 (D. Alas.), *aff'd,* 414 U.S. 1105 (1973) (refusal to review forced retirement from National Guard).

Defendant notes that this court has, in the past, acknowledged that it is possible for a federal employee to

be adjudged physically able for disability retirement purposes, and yet too physically unfit to continue to perform the duties of his position. *Piccone* v. *United States*, 186 Ct. Cl. 752, 762–63, 407 F.2d 866, 872 (1969). *Piccone*, defendant argues, is controlling here. Plaintiff, like Piccone, has been found physically unfit to perform his duties as a technician, but is nevertheless not so disabled as to qualify for disability retirement. If plaintiff's position were purely civilian, and the decision initially to retire him as disabled had been that of the Civil Service Commission, we would not quarrel with defendant's analysis. Again, however, plaintiff, unlike Piccone, was retired because of military action. Defendant overlooks the military aspects of his employment which take this case out of the rule fashioned in *Piccone*.

Finally, defendant asserts that *Chaudoin* v. *Atkinson*, *supra*, demonstrates that technicians perform two separate jobs, albeit simultaneously. This, defendant argues, follows because *Chaudoin* held that National Guard officers' attempt to force a technician to perform certain military duties was illegal. In *Chaudoin*, however, the plaintiff was directed to engage in military activities which were unrelated to his primary duties as a technician. This does not mean that the technician position is purely civilian, but simply that technicians are expected only to perform those military duties, which for the most part mesh with civilian duties, which are part of the job description. *See* 494 F.2d at 1331–32.

Defendant's fundamental error is its failure to accord proper weight to the definition in Section 8331(6) defining "disability" as being disability "for useful and efficient service in the grade or class of position last occupied." Defendant persists in thinking about plaintiff's fitness for the duties of a civilian job with no military connection. This is not the position plaintiff last occupied. That was one in which military duties were an inseparable component. If he was unfit for them, he was unfit for the job. The statute does not allow the Commission to deny disability retirement because the retiree is fit for some other job than the one he occupied. Thus the Commission has made a plain error of law, one not supported by the respect we are

required to accord and do accord to the Commission's expertise. That respect does not allow it a "misconstruction of the governing legislation" in the phrase from *Gaines* v. *United States*, quoted *supra*.

In conclusion, we hold that the findings of the FEAA and BRIOH that plaintiff is not totally disabled for purposes of 5 U.S.C. § 8331 are legally erroneous. In light of the National Guard Technicians Act, the Civil Service Commission must defer to the military judgment in this regard. In the judgment of the military, plaintiff is physically disabled for technician employment. Thus, he should be eligible for a disability annuity.

Accordingly, plaintiff's motion for summary judgment is granted and defendant's cross-motion for summary judgment is denied. It is hereby ordered that plaintiff's record with the Civil Service Commission be corrected to show that he has been retired for physical disability since May 24, 1975. Judgment is entered for plaintiff and the cause is remanded to the Trial Division under Rule 131(c) to determine the quantum of recovery.

BENNETT, *Judge*, dissenting:

I respectfully dissent from the opinion of the court because it has rewritten the statutes applicable to this case, and I believe that it is appropriate only for the Congress to do so.

At first blush one might conclude that without the court's aid plaintiff is in a no-win situation. Because he was found physically unfit to continue as a member of the Texas Air National Guard (ANG), he lost his civilian position as a production controller technician with the Guard. But, the court properly observes that this was mandated by statute. 32 U.S.C. § 709(e)(1). Plaintiff was given and receives a discontinued service annuity under 5 U.S.C. § 8336(d). Now plaintiff wants instead a disability retirement annuity under the Federal Retirement Program for civilian employees. The latter annuity was denied by the Civil Service Commission which, after a hearing and appellate review, found that plaintiff suffered from a condition pre-existing his position and that he was not

totally disabled. The military had found plaintiff not qualified for general military service and worldwide duty by reason of diabetes. His military responsibilities required occasional foreign travel and this made it difficult for him to adhere to a restricted diet and to maintain insulin regulation. There is nothing to indicate that, except for the foreign travel problem, plaintiff could not or did not perform his duties adequately. Indeed, there is uncontroverted evidence that he could do so and that he was not totally disabled. The Civil Service Commission agreed, in denying his claim, as noted. Is plaintiff entitled to a disability retirement annuity anyway? The court says that he is. It does so by making this conclusion:

> * * * It would seem only fair that there be a single standard in determining physical fitness for employment as a technician. In light of section 709(e) and settled law respecting reviewability of military determinations, it is preferable that the military standard prevail when there is disagreement. * * *

If Congress had wanted this to be the rule, it knew how to say so. But, it did not require that the Civil Service Commission defer to the military judgment by enacting the National Guard Technicians Act, and there is nothing at all in section 709 to support the court's position. Technicians remain under the Civil Service and not military law, so far as retirement rights are concerned. Qualifications for the military position plaintiff held were governed by military requirements. When plaintiff failed to meet those standards, he lost his civilian job by operation of law. This does not, however, entitle plaintiff, by operation of law, to a disability retirement under title 5 of the United States Code. Section 8331(6) says:

> (6) "disabled" and "disability" mean *totally disabled or total disability,* respectively, for useful and efficient service in the grade or class of position last occupied * * * [emphasis supplied].

Another section, 5 U.S.C. § 8347(c), provides:

> (c) *The Commission shall determine questions of disability* and dependency arising under this subchapter. *The decisions* of the Commission concerning these matters

are final and conclusive and are not subject to review. * * * [emphasis supplied].

The court surmounts the foregoing language by ruling that, in ignoring the dual nature of plaintiff's positions and the National Guard Technicians Act, the Commission made a mistake and its findings simply must be set aside. The court says: "In view of this, we find that the civilian and military duties imposed on plaintiff constitute a single job for purposes of determining disability and resultant retirement benefits." This flies in the face of the law and the facts. Plaintiff has no right to a disability retirement annuity unless he comes within the statutory provisions and their implementing regulations. He does not. The CSC has not found him to be totally disabled from useful and efficient service. Its decision is final. Not even the ANG found that plaintiff was totally disabled for useful and efficient service but only that he was unfit for general worldwide military service.

The court seems to be under a misapprehension that the National Guard Technicians Act somehow changed the responsibility given to the CSC for these decisions under 5 U.S.C. §§ 8331(6), 8337(a), and 8347(c). It did not do so. That Act had the purpose of giving Guard technicians the same retirement benefits as other federal employees. 3 U.S. CODE CONG. & ADM. NEWS 3320 (1968). It did not seek to give technicians greater disability benefits than other federal employees. But, the court does so. This is not insignificant, as counsel assured us at oral argument that approximately 50,000 technicians are potentially affected by this case. The court's syllogism fails because it does not follow that if plaintiff is unfit for general, worldwide military duty he is also "totally disabled" from his civilian position and that the CSC is deprived of the discretion given to it by statute to rule otherwise. Nor is it correct to say that plaintiff's two positions are the same. The duties of a civilian technician are not the same as those of an Air National Guardsman on active duty. Plaintiff was retired from his civilian position, and it is his civilian duties that are relevant to the question of entitlement to civilian disability benefits. The CSC did not abuse its discretion in applying the law, and we thus have no jurisdiction to upset its

decision made final by statute. If Congress wishes to prefer these technicians over other civilian government employees and to give the military, instead of the Civil Service Commission, the right to say with finality who is disabled and entitled to a disability annuity, it can rewrite the statutes. The court should refrain from doing so, whatever the appeal of the particular case.

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571 F. 2d 1162

MILLS MANUFACTURING CORPORATION v. THE UNITED STATES

[Nos. 607–71, 655–71 and 697–71. Decided February 22, 1978]

ON THE PROOFS

Renegotiation of contracts; redetermination of excessive profits.—Since the Korean War plaintiff has been engaged exclusively in the manufacture of four types of military parachutes for the United States. All of its contracts for production of these items were obtained as a result of competitive bidding on advertised procurements and were on a firm, fixed price basis. Plaintiff was responsible for all costs of manufacture, receiving no loans, advance payments, or Government-furnished materials. Plaintiff was eligible for both small business and labor surplus "set-aside" awards. The Renegotiation Board determined that plaintiff had realized excessive profits for its fiscal years 1967, 1968 and 1969, of $500,000, $550,000 and $150,000, respectively, and plaintiff seeks de novo review of those determinations. It is *held* that, in view of the tremendous increase in wartime demand, the evidence of market imperfections, and the size of the increase in external investments, cash on hand and additions to net worth, when combined with the difference in plaintiff's earnings and those of firms which plaintiff introduced as comparable, plaintiff earned excessive profits in 1967 and 1968 of $425,000 and $350,000, respectively, but that no excessive profits were earned in 1969. Judgment is entered on defendant's counterclaim for $775,000, less appropriate state and Federal tax credits, plus statutory interest thereon for 1967 and 1968. Defendant's counterclaim respecting 1969 is dismissed.

Renegotiation of contracts; redetermination of excessive profits; generally.

[1] The ultimate purpose of renegotiation is largely to approximate the norm in the competitive market, and the statutory factors and regulations attempt to insure that the proper considerations are taken

Syllabus

into account in attempting to fill in the gaps wartime procurement may make in the competitive process.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; competition.

[2] In the renegotiation process when the analysis over-stresses the asserted competitiveness of the particular market, the result is a by-passing of the required analysis under the statutory factors and is contrary to the flexibility of approach that forms the very purpose of the statutory system. Over-emphasis on the presence or absence of competition puts too great a strain upon the allocation of burden of proof in the renegotiation process. The presence of market power by a contractor—that is a market dislocation—does not necessarily indicate the presence of excessive profits.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; generally.

[3] There is no presumption that a particular form of contractual system, for instance competitively bid fixed price contracts, in and of itself, shows the absence of excessive profits. There must always be further particularized inquiry.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; evidence; burden of proof and persuasion.

[4] The Government, though it has the burden of showing excessive profits, does not also have the separate burden of showing absence of competition, on pain of a clearance for the contractor.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; generally.

[5] The whole process of renegotiation recognizes the danger that even normally competitive markets may not continue to be so during a wartime buildup.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; generally.

[6] Acceptance of set-aside awards, under the program of the Small Business Administration and the Labor Department, would itself be evidence that a business thought itself capable of making a reasonable profit at a price lower than it submitted in its bid on a contract subject to renegotiation.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; competition.

[7] Although there may be many possible reasons for a variance in prices awarded for contracts over a short period of time to the same

contractor, such variance may be indicative of the absence of a full competitive market.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; generally.

[8] Although use of the competitively bid fixed price procurement method complying with the standards of 32 C.F.R. §§ 3–401(b)(6) and 3–404.2(a)–(b) is a factor to be considered in insuring that no excessive profits would exist, administratively setting a felt "sound price" does not guarantee that excessive profits have not been earned.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; accumulative basis; review period.

[9] An attempt to determine excessive profits on an accumulative basis for the several review years is contrary to the fiscal year basis of the Renegotiation Act.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; historical norm.

[10] To include the review years in a contractor's computation of the historical norm results in an analytical anomaly—use of the review years in the calculation of the average against which those years are to be compared reduces the discrepancy between the review and base years, thereby defeating the purpose of the comparison. Prevention of use of such an adjusted historical norm as a ceiling on the reasonableness of the contractor's profits is best attained through proper adjustments to the norm under the statutory factors, not by adjusting the calculation of the norm itself.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; historical norm.

[11] In the use of the historical norm to determine existence of excessive profits of a contractor whose operations during the review years are distinguishable from those of its prior history primarily through substantial differences in volume and not in the military product it made, the determinative factor as to the utility of the base period analysis would be the time of production, not the purchaser's identity.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; historical norm.

[12] Use of an historical norm as the initial step in determining existence of excessive profits is a venerable process in renegotiation cases.

War and National Defense ⚖59

Syllabus

Renegotiation of contracts; redetermination of excessive profits; profit-to-sales v. profit-to-net worth ratio.

[13] Use of a profit-to-sales ratio and of a profit-to-net worth ratio constitutes the two most frequently used devices in renegotiation to measure profit relationships statistically.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; profit relationship; profit-to-sales ratio.

[14] Where the contractor undergoing renegotiation is a non-capital intensive industry and the issue largely concerns the increased volume of goods produced during the review years, in making comparisons the more significant standard to use is the profit-to-sales ratio.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; efficiency of contractor; burden of proof.

[15] Efficiency in some absolute sense does not exist in any business, but is a comparative concept. It is not the contractor's burden to establish an increase in efficiency in the renegotiation process. Once the contractor has met its prima facie burden for favorable consideration under this factor, it is the Government's burden to establish the lack of increased efficiency during the years under review. Concern with increase in efficiency should not result in undue emphasis upon base period averages.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; efficiency of contractor.

[16] While intense utilization of a plant through multiple shifts is not alone an increase in efficiency, intensive asset utilization evokes increased efficiency if the contractor is able to control diseconomies resulting from the attempt to produce more volume from a fixed asset base when compared with members of its industry.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; evidence; burden of proof and persuasion.

[17] Defendant, having the ultimate burden of proof in renegotiation, must bear the adverse implications of the thinness of the comparative data, unless, perhaps, the absence of data was the contractor's responsibility.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; profit-use analysis.

[18] Where, during the review years, plaintiff amassed substantial cash on hand, its net worth increased, and its nonparachute business investments grew substantially, such evidence, although not establishing in itself that plaintiff fails to merit favorable consideration under the statutory factors, does result in less certainty as to the extent of favorable consideration under the particular statutory factors and in more receptivity to the idea that plaintiff's business during the review

Syllabus

years arose, not from factors for which it was responsible, but from wartime conditions which tend to enhance its gain.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; extent of risk assumed.

[19] An essential quality of firm, fixed price contracts is that the contractor assumes responsibility for its costs, with the inevitable risk that greater costs than anticipated will be incurred and that a loss on the contract can result. Assessment of risk is essentially a comparative exercise. Such presence of risk will not entitle the renegotiated contractor to more or less profit under this factor than is merited by an otherwise comparable firm. Thus, favorable recognition must require an increased assumption of risk. Risks must be more than speculative to be considered.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; review by court.

[20] The redetermination of excessive profits is a de novo proceeding in this court, and the prior decisions of the Renegotiation Board are not conclusive. The suggestive use of the Board's judgment, however, is permitted and does not prejudice the de novo character of the proceeding.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; comparable industry.

[21] In evaluating a renegotiated contractor's performance, where comparisons have been made only with post-renegotiation profit figures of other renegotiated manufacturers in the same business, such figures supposedly remove any excessive profits realized in the firms' review years and thus theoretically provide a standard against which the contractor's review year performance can be measured. The court's lack of knowledge of information before the Board is here partially offset by plaintiff's acceptance of these profit figures.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; generally.

[22] The determinations of the amount of excessive profits is very far from an exact science and very often a broad-brush technique or general estimate is called for.

War and National Defense ⚖59

Walter A.I. Wilson for plaintiff; *John T. Koehler*, attorney of record; *Hudson, Creyke, Koehler & Tacke*, of counsel.

C. Max Vassanelli, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant. *Gerald D. Freed*, of counsel.

Before DURFEE, *Senior Judge*,* DAVIS and KASHIWA, *Judges*.

DAVIS, *Judge*, delivered the opinion of the court:

These renegotiation cases, in which plaintiff's profits for its fiscal years 1967, 1968 and 1969, are at issue, come before the court on defendant's exceptions to findings of fact and recommended decision by Trial Judge Harkins. The Renegotiation Board determined that plaintiff had realized excessive profits in the amount of $500,000 for its fiscal year 1967, $550,000 for 1968, and $150,000 for 1969. Plaintiff petitioned the United States Tax Court for a redetermination of the board's orders for 1967 and 1968, on May 16, 1969 and August 24, 1970, respectively. Pursuant to the extension of the Renegotiation Act of 1951, Pub. L. No. 92-41 § 3, 85 Stat. 97 (1971), these cases were transferred to the Court of Claims on July 29, 1971 for 1968, and August 2, 1971, for 1967. Plaintiff petitioned the Court of Claims for a *de novo* redetermination of the board's order for 1969 on August 25, 1971. 50 U.S.C. app. § 1218 (1970) & (Supp. V 1975). On March 29, 1974, the cases were consolidated. Contrary to the board, the trial judge concluded that the Government had not met its burden of proof and that consequently Mills deserved a clearance for each of the years under review. We cannot completely agree and find that Mills earned excessive profits in the amount of $425,000 for 1967, and $350,000 for 1968. For 1969, however, we affirm the clearance given by the Trial Division.[1]

I.

Since the Korean War, Mills Manufacturing Corp., has been engaged exclusively in the manufacture of various

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* Senior Judge Durfee heard the argument but died before the preparation and adoption of this opinion.

[1] The necessary findings of fact are contained in this opinion.

types of military parachutes for the United States and has enjoyed a good reputation both as one of the most efficient parachute manufacturers in the field and as a supplier of high quality products. Mills has manufactured four types of parachutes: flare, personnel, cargo and deceleration. Flare parachutes, used in connection with the aerial delivery of various types of illuminating flares, are the least complex to manufacture, requiring smaller manufacturing space and less labor. They are manufactured on a production line basis and involve a cutting, stitching and threading operation most comparable to textile fabrication. Manufacture of personnel, cargo, and deceleration parachutes involve more complex techniques, procedures and skills which are considerably more difficult than those customarily found in commercial textile fabrication. Mills made four models of personnel parachutes, each model manufactured to precise specifications that controlled weight, construction, and strength of canopy fabrics and suspension lines, as well as the size, type and number of stitches, seams and hems. The cargo parachute was even more complex, constituting Mills' most time-demanding production item. The deceleration parachute made by Mills was a complex item functioning as an ancillary braking mechanism for the F-100 series of fighter aircraft. Operational requirements demanded a small diameter canopy that combined light weight with the ability to sustain payloads ranging up to 48,400 pounds.

All of plaintiff's contracts for the production of these items were obtained as a result of competitive bidding on advertised procurements and were on a firm, fixed price basis. The company was also responsible for all costs of manufacture, receiving no loans, advance payments, or government furnished materials from defendant. Plaintiff was, however, eligible for both small business and labor surplus "set-aside" awards through which it would be allowed to accept a portion of a procurement order (up to 50%) at the lowest bid price, even though plaintiff had originally submitted a higher bid. Approximately one third of Mills' total review period sales resulted from acceptance of set-aside portions.

The 1967–69 review years were a period of change in the military parachute market in general, as well as in Mills' own activity. The total value of defense procurements of military parachutes more than doubled from the $27.8 million in 1965 to the $62.6 million in 1967. The number of contracts awarded by the Department of Defense rose from 290 in 1965 to a high of 456 in 1968, while the number of contractors filling those orders rose from 57 in 1965 to a high of 88 in 1967. Nevertheless, there was a tendency towards price stability or price decline in government purchases of parachutes during that time (while the industry's profitability, on a return-on-sales basis, more than doubled its 1965 level). Changes occurring to Mills' business during this period can be summarized in tabular form as follows:

Year	*Sales (000)*	*Equity (000)*	*Profit (000)*	*Return on sales*		*Return on equity*		*Renegotiation Board action*
1962	2,773	613	60	2.17		9.81		clearance
1963	5,005	642	246	4.92		38.37		clearance
1964	6,482	747	582	8.98		78.00		clearance
1965	6,588	1,000	465	7.06		46.49		clearance
1966	8,562	1,214	824	9.62		67.84		clearance
1967*	13,376	1,563	1,827	13.7	10.4**	116.9	84.9**	500,000
1968*	10,256	2,014	1,466	14.3	9.5**	72.8	45.5**	550,000
1969*	11,346	2,539	1,252	10.5	9.7**	49.3	43.4**	150,000

* Years under review

** Ratio after Renegotiation Board determinations of excessive profit.

Profits, sales, equity and their ratios made increases in this three year period. Mills also increased the number of its employees; shifted the mix of parachutes it made—increasing flare parachute production, decreasing personnel parachute production, and decreasing, then increasing, its production of cargo parachutes; and increased the proportion of its contracts performed as subcontracts.

We must determine, of course, whether these changes, occurring during the period of peak, Vietnam wartime procurement, are indicative of the recovery by Mills of excessive profits which the Government is entitled to recover.

II.

The parties have spent a great deal of time briefing and arguing the role of competition and market analysis in renegotiation. The difficulty does not lie in recognition that contracts awarded in a truly competitive market produce reasonable profits. The ultimate purpose of renegotiation is to approximate that competitive norm, and the statutory factors and regulations attempt to insure that the proper considerations are taken into account in attempting to fill in the gaps wartime procurement may make in the competitive process. *Major Coat Co. v. United States*, 211 Ct. Cl. 1, 23, 543 F. 2d 97, 110 (1976); *Mason & Hanger-Silas Mason Co.* v. *United States*, 207 Ct. Cl. 106, 115–17, 518 F.2d 1341, 1346–48 (1975). The difference between the parties lies in deciding how the presence of a competitive market is to be determined and who has the burden of such proof. Mills' argument is essentially one based upon its burden of proof in renegotiation. *Lykes Bros. S.S. Co.* v. *United States*, 198 Ct. Cl. 312, 459 F.2d 1393 (1972). Relying upon its evidence of the number of contractors in the parachute market and the number of contractors actually bidding against plaintiff during the review years, plaintiff asserts that it has met its burden of going forward as to the existence of competition in the parachute market, and that a presumption is thus raised that its profits were reasonable.[2] The Government's failure to present evidence to overcome this prima facie case for competition is said to mandate a clearance for the review years. The Government contends that the trial judge has adopted this position and that the necessary result is that contractors will find this such an easy prima facie path that the Government will

[2] Mills does not, however, rely exclusively on this argument. Elsewhere it argues that its entitlement to favorable consideration under several statutory factors warrants its clearance for the years under review.

have to prove an antitrust case on market dislocations before excessive profits can be found. Such a burden, it is alleged, will result in an exemption under the Renegotiation Act, 50 U.S.C. app. §§ 1211–1224 (1970 & Supp. V 1975), for competitively bid, fixed price contracts.

Although we do not think that the trial judge created a de facto exemption for competitively bid fixed price contracts, we do disagree with giving it as much importance as he does in the renegotiation process. When the analysis over-stresses the presumed competitiveness of the particular market, the result is a by-passing of the required analysis under the statutory factors. 50 U.S.C. app. § 1213(e) (1970). As noted above, the ultimate objective of renegotiation is to approximate a competitive norm. *Major Coat*, 211 Ct. Cl. at 22–23, 543 F.2d at 110. If it is established or "presumed" in advance that full competition exists in a particular market, consideration of the firm's efficiency, risk, and other statutorily mandated factors would necessarily be much lessened. Use of such a single formula would thus be contrary to the flexibility of approach that has formed the very purpose of the statutory system. *Mason & Hanger*, 207 Ct. Cl. at 117, 518 F.2d at 1346; *A.C. Ball Co. v. United States*, 209 Ct. Cl. 223, 263, 531 F.2d 993, 1015–16 (1976). Furthermore, over-emphasis on the presence or absence of competition puts too great a strain upon the allocation of burden of proof in renegotiation cases. Those burdens were established with specific reference to the statutory factors, *Lykes Bros.*, 198 Ct. Cl. at 326, 327, 459 F.2d at 1401, and to the existence and amount of excessive profits. There is no presumption that a particular form of contractual system, in and of itself, shows the absence of excessive profits. There must always be some further particularized inquiry. In *Major Coat*, for example, the court found in the dislocations caused by the buildup of wartime production and the use of rated orders, evidencing pressure on productive capacity, an absence of competition sufficient to permit renegotiation and to preclude comparison with other manufacturers of the same product. Determinative for these two purposes was the existence of the potential for excessive profits, 211 Ct. Cl. at 27, 543 F.2d at 112; the problem was not analyzed simply in

accordance with the *Lykes* burdens. Again, in *A.C. Ball*, 209 Ct. Cl. at 261, 262, 531 F.2d at 1015, the contractor worked under firm fixed price contracts awarded on the basis of competitive bidding. The court treated half of the contractor's profits as being attributable to a diminution of competition and half not. Finding no diminution of competition in the latter half did not result in an automatic clearance because the Government had not proven that market dislocations existed; instead, the court continued to consider whether the contractor merited favorable consideration under any of the statutory factors and placed the burden upon the Government as to those statutory factors.

That the Government, though it has the burden of showing excessive profits, does not also have the separate burden of showing absence of competition, on pain of a clearance for the contractor, also appears from others of our decisions. In *Butkin Precision Mfg. Corp. v. United States*, 211 Ct. Cl. 110, 544 F. 2d 499 (1976), an alternative basis for the clearance was the Government's failure to "cap" a statutory factor conceded to be in the contractor's favor; yet the court recognized that an uncapped factor could have inherent limits which would not produce an automatic clearance. *Id.* at 130–31, 544 F.2d at 510–11. Similarly, the highest profitability on the profit hierarchy, warranted if there is a failure in the Government's proof, need not necessarily result in a clearance. *Major Coat*, 211 Ct. Cl. at 47, 543 F.2d at 123–24. See *Camel Mfg Co.* v. *United States*, *ante* at 460.

Overemphasis upon market structure as such is not only contrary to Congressional directives and to prior decisions of this court, but it also seems contrary to the overall scheme of renegotiation. The presence of market power by a contractor—that is, a market dislocation—does not necessarily indicate the presence of excessive profits. The contractor may not have used his market power to capture extra profits, *Major Coat*, 211 Ct. Cl. at 26, 543 F.2d at 111, or favorable consideration under a statutory factor such as contribution to the defense effort may warrant a greater than competitive return, *id.* at 41, 543 F.2d at 120.

Moreover, were we to accept plaintiff's position on the role and burden of proof on competition, there would be an asymmetry in the working of renegotiation—if defendant did not prove the existence of market dislocations, a clearance would be required; however, if proof of dislocations were forthcoming, it would still be necessary to undertake the traditional analysis under the statutory factors to determine if excessive profits had been earned. *Cf. A.C. Ball*, 209 Ct. Cl. at 262–63, 531 F.2d at 1015–16 (assumed distortion of competition found to still require analysis under statutory factors). We see no reason to place such an added burden upon the Government's case.

Yet we do not wish to be seen as denying the relevance of indications of the presence or absence of competition in a particular market. A strong showing of effective competition by plaintiff, for example, might make us more inclined to credit ambiguous evidence of increased efficiency or to give greater credit for the reasonableness of costs. 50 U.S.C. app. 1213(e). In this case, however, there are enough difficulties with the evidence of full competition to preclude our giving it great weight in even this more restricted sense.

Our fundamental difficulty with the evidence of competition in the parachute procurement market, and one which every contractor making that claim must overcome, is that the premise of statutory renegotiation is that "accurate pricing and the control of contractors' profits cannot be achieved during a build-up of production for defense of war." *Mason & Hanger*, 207 Ct. Cl. at 115, 518 F.2d, 1346–47. The grossly increased demand, the requirement of unprecedented speed, and the predominant interest of procurement officials in volume of purchases all preclude careful cost analysis and sound purchasing. *Id* at 115–16, 518 F.2d at 1347. And if the sudden large increase in demand does not create a loss of price competition, then "the knowledge that the demand is short-term and will just as suddenly fall off surely accomplishes the task." *Major Coat*, 211 Ct. Cl. at 23, 543 F.2d at 110. The whole process of renegotiation recognizes the danger that even normally competitive markets may not continue to be so during a wartime buildup. Indeed, in *A.C. Ball*, 209 Ct. Cl. at 263,

260, 261, 531 F.2d at 1016, 1014, 1015, the "consequent distortion of the competitive market" due to the increased government demand provided the basis for recovery of some of the contractor's profits. It follows that there is no necessary correlation between the lowest bid price and the price consistent with a reasonable profit, for under such competitively imperfect conditions the lowest bid price may still permit the existence of excessive profits. *Gibraltar Mfg. Co. v. United States*, 212 Ct. Cl. 226, 238–39, 546 F. 2d 386, 393–94 (1976).

Other more specific considerations reinforce our belief that the parachute procurement market may have been less than fully competitive during the peak years of Vietnam procurement. Of particular interest is the number of parachute suppliers relied upon by Mills as part of its prima facie case. In 1965, there were 57 contractors providing $27.8 million worth of parachutes; by 1967, 88 suppliers sold $62.6 million worth of parachutes, with the number remaining approximately that high in the other two review years. On its face, so many suppliers might seem to be strong evidence of effective competition in the parachute market. Yet of those eighty-eight suppliers, only about fifteen were regularly active parachute manufacturers, of which nine or ten were recognized as established supply sources for military parachutes. During the three years under review, Mills in fact competed against only thirty-five of these firms, and on the average against only 5.95 qualified bidders for each separate procurement. While we in no way indicate the number of firms required before full competition can, if ever, be found, these figures indicate that the question is closer than plaintiff would have us believe.[3] Furthermore the increase of suppliers of military parachutes during the review years may itself be evidence of the existence of large profits in this market. *See Major Coat*, 211 Ct. Cl. at 23, 543 F.2d at 110. The

[3] Indeed, we note that in *Butkin*, the contractor also worked under firm, fixed price contracts awarded on the basis of competitive bidding in a market consisting of 25–30 "exceptional" competitors. Yet the court never said the contractor's profits were reasonable because it was the lowest bidder on the contracts it performed; nor did it say the Government failed in its burden because it failed to prove market dislocations.

voluntary decision of these new entrants to leave their prior businesses to manufacture military parachutes could have been based upon the determination that the profits there realized would be greater than those made in their prior business. Given the fact that parachute manufacture was the most complex of textile manufacturing processes and that the difference between other companies and regular parachute manufacturers was considered so great that the trial judge refused to compare Mills with any other kinds of companies, there is a likelihood that these new entrants would be initally less competitive than the regular suppliers. *Cf. Gibraltar*, 212 Ct. Cl at 233, 546 F.2d at 390 (concentration of firm on particular market found to be a major factor in its ability to be low bidder). There would thus probably have to be some significant market dislocations in the parachute industry, in the reviewing years, before these firms could enter at a competitive disadvantage.

Further indication that the evidence does not compel the finding that plaintiff's market was fully competitive is found in the set-aside program of the Small Business Administration and the Labor Department. Under these programs, qualified firms have the opportunity to match the lowest bid for a contract, taking up to 50 percent of the contract at that price. Only one among Mills' competitors, Automotive Textile Products, did not qualify under this program. Thus there may have been less incentive for each firm to submit the lowest possible price consistent with a reasonable profit because there always existed the possibility that they would be able to receive part of the contract as a set-aside. Indeed, acceptance of set aside awards would itself be evidence that the firm thought itself capable of making a profit at a price lower than it submitted in its bid. Mills accepted at least $3.2 million of such contracts over the review period. In short, the set-aside practice provides us with less than full faith in the assumption that each firm submitted fully competitive bids. *Cf. Major Coat*, 211 Ct. Cl. at 23, 543 F.2d at 110 (common knowledge of the short term nature of the wartime demand destroys competition in the market).

Just as the bids submitted need not have been competitively determined, the variance in the prices awarded for the contracts may also be indicative of the absence of full competition. For example, on January 28, 1966, Mills was awarded a contract for 1450 units of 24' personnel parachutes at a price of $85.14 per unit; on March 3, 1966, Mills agreed to manufacture, as a set aside, 8645 units of this product at $83.99 per unit. Four days later, Mills won a contract for 1450 units at $88.20 per unit. Although there are many possible reasons for this variance in prices, such a pricing pattern would not be inconsistent with less than a full competitive market.[4]

Finally, little weight can be given to the argument that since the government procurement officials utilized the competitively bid fixed price procurement method, they must, under the standards of the Armed Services Procurement Regulations, have known enough about the pricing of contracts in this market to insure, as in a competitive market, that no excessive profits would exist. 32 C.F.R. §§ 3–401(b)(6), 3–404.2(a) (b) (1975). Although use of this type of procurement under these standards is certainly a factor to be considered, administratively setting a felt "sound price" does not guarantee that excessive profits have not been earned. The argument is somewhat circular, for if these officials made a mistake in their judgment it would show up as excessive profits, whose existence is here at issue. Moreover, placing too much emphasis upon the decision to use competitively bid, fixed-price procurements may have the deleterious effect of decreasing the use of this type of procurement by procurement officials. *See* 32 C.F.R. §§ 3–401(b)(6), 3–404.2(a)(b) (1975).

Finding the evidence far less than conclusive that the military parachute market was perfectly competitive during the 1967–69 period, we come to consider the appropriate criteria for determining excessive profits in this case, including the specified statutory factors. 50 U.S.C. app. § 1213(e) (1970).

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[4] The absence of data from either side precludes our putting too much weight on this aspect.

III.

The foundation of the Government's case is its comparison of Mills' profits in the review years with the firm's profits in an earlier period. Under the Government's theory, the variance between the review and base years constitutes the amount of excessive profits earned by Mills, except for a 10% allowance whose rationale is not explained.[5] While agreeing that the historical norm constitutes only a starting point, the Government felt Mills merited favorable consideration under none of the statutory factors, though it was willing to give Mills some compensation for its constant efficiency; by applying the historical rate of return over a vastly expanded volume of production induced by Vietnam wartime demand, Mills would receive the benefit of its decreasing unit costs, caused by the spreading of its fixed costs over that expanded volume, as a sufficient reward for its efficiency. Thus, in effect, the historical average would constitute a ceiling on the reasonableness of Mills' profits. The other analyses performed by the Government's expert—the break-even analysis, the product-mix analysis and the profit-use analysis—are all said to "verify" the conclusions drawn from this historical norm analysis. Plaintiff, while objecting to use of the historical norm as a "ceiling," accepts the value of comparing its review year profits with those of a span of time, while differing with the Govern-

[5] Before the trial judge, defendant's expert could not give a precise breakdown of claimed excessive profits for each of the review years, but determined excessive profits on an accumulative basis for the three review years. This attempt to compute excessive profits for the combined three-year review period is contrary to the fiscal year basis of the Renegotiation Act. *See A.C. Ball Co. v. United States*, 209 Ct. Cl. 223, 258, 531 F.2d 993, 1012 (1976); 50 U.S.C. app. § 1215(a) (Supp. V, 1975); 32 C.F.R. § 1457.1(b)(1976); 32 C.F.R. § 1459.9(a)-(f) (1976). Defendant attempted to remedy this shortcoming by calculating the difference between the historical return on sales and the actual profit for each of the review years and labelling 90% of such difference as excessive. Mills, aside from its basic objection to use of the historical norm as a ceiling, finds the 10% allowance arbitrary and objects to the lack of opportunity for cross-examination on this approach. To the extent that the 10% allowance is arbitrary, it is an allowance contrary to defendant's theory and works to the plaintiff's favor. As to the second objection, the calculations are so consistent with defendant's theory of the case that recalculation on a yearly basis in accord with that theory does not seem to constitute an unfair surprise for Mills. Certainly such error under these circumstances cannot mandate a clearance for the entire review period.

ment as to the proper length of time to be used as the norm.

Defendant proposes a norm comprising Mills' earnings from 1963–66. Traditional financial analysis normally permits a five year period, but defendant dropped 1962 because it was a "low" year.[6] Such a concession benefits plaintiff because the historical norm's average is not brought down. Indeed, use of this four year period benefits plaintiff in that, other than the review years, they constitute the best in Mills' history. Plaintiff, however, proposes using a longer, nine year period for the historical norm. It is admitted by Mills that the 1964–66 period was "relatively normal." Yet the company says that, since it is a single product defense supplier and thus operates in a "cyclical market," it is inappropriate to use such a four year period; instead for such a company, the historical norm is said to require the inclusion of a low period (1961–63) as well as a high period (1967–69, the review years). Such a rounded average will avoid, it is urged, using the normal earnings as a ceiling.

Mills' conception of the historical norm cannot be accepted. As noted by the trial judge, plaintiff's inclusion of the review years in its computation of the historical norm results in an analytical anomaly—use of the review years in the calculation of the average against which those years are to be compared reduces the discrepancy between the review and base years, thereby defeating the very purpose of the comparison. Adjustments to the historical norm, as advocated by plaintiff, might also be counterproductive in that they could serve to justify giving greater weight to the base period ratios than they merit. Prevention of use of such an historical norm as a ceiling is best attained through proper adjustments to the norm under the statutory factors—not through attempts to second-guess the process by adjusting the calculation of the norm itself. Finally, to the extent plaintiff's position is based upon the "cyclical" nature of its business, it is misplaced. If by cyclical plaintiff means that the volume of its production in the wartime

[6] In 1962, Mills' sales, its profit to sales ratio, and its profit to owners' equity ratio were substantially below the corresponding figures for the three years prior to 1962 and for the four years following 1962.

review years has risen sharply, this is a circumstance shared by most companies entering into renegotiable contracts, and was indeed a fundamental reason for enactment of the Renegotiation Act. *Mason & Hanger*, 207 Ct. Cl. at 139, 518 F.2d at 1361.

The trial judge, however, refused to find and compare a base period with the review period. Rather, he limited the use of historical norm analyses to situations where the company either converted from a commercial product to the military product subject to renegotiation or produced a product with both war and peacetime uses. *See Mason & Hanger*, 207 Ct. Cl. at 151, 518 F.2d at 1367–68 (dissenting opinion). Since the type and volume of parachutes sold by Mills were determined by the military uses to which they were put, the trial judge ruled that military parachutes could not be divided into wartime and peacetime products. Because Mills had never had a commercial line of business, he concluded that the earnings of the company in prior years could not be compared to the earnings of the review years.

Use of the historical norm need not be so restricted. In *Gibraltar*, plaintiff was also a single product manufacturer selling exclusively to the military. That fact did not preclude recovery of excessive profits even though the Government relied principally upon an historical norm analysis. The court there specifically endorsed the use of an historical norm. *Gibraltar*, 212 Ct. Cl. 235, 546 F.2d at 391. The difficulty of finding other companies similar enough to be accurately compared with the company being reviewed also makes comparisons with the company's prior history particularly valuable. This is especially true where, as here, the contractor's operations during the review years are distinguishable from those of its prior history primarily through substantial differences in volume. *Cf. Gibraltar*, *id* at 235, 546 F.2d at 391. Instead of referring to the time during which the product was sold as being one of wartime or peacetime, the trial judge found determinative the party to whom the product was sold. Although Mills' demand for its product was dictated by the use to which it was put by the military, that peacetime demand was sufficient enough, and profitable enough, to induce Mills to

stay exclusively in the military parachute market. *Cf. Mason & Hanger,* 207 Ct. Cl. at 119, 518 F.2d 1349 (private industry unwilling to invest in ammunitions plants because of insufficient returns). Certainly Mills, in order to secure a reasonable profit, did not depend upon sporadic wars to provide it with increased demand for its product;[7] in those circumstances the determinative factor as to the utility of base period analysis would be the time of production, not the purchaser's identity. *See Mason & Hanger,* 207 Ct. Cl. at 138, 518 F.2d at 1360. In addition, use of an historical norm as the initial step in determining the existence of excessive profits is a venerable process in renegotiation cases. *See, e.g., Butkin Precision Mfg. Corp. v. United States,* 211 Ct. Cl. at 120–21, 544 F.2d at 499, 505–06. Indeed its use is specifically endorsed by the regulations of the Renegotiation Board.[8] 32 C.F.R. § 1460.10(b)(1) (1976). Mills having conceded the general normalcy of the 1964–66 period, we see no great discrepancy in the average caused by the inclusion of 1963 within the base period, and accordingly adopt the 1963–66 period as representing Mills' base-years profitability.[9]

Use of a profit-to-sales ratio and of a profit-to-net-worth ratio[10] constitutes the two most frequently used devices in renegotiation to measure profit relationships statistically. Mills' average rates of return on sales and on beginning net worth for the four-year historical base period were 7.95% and 58.7% respectively. Applying each historical ratio to

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[7] The trial judge seemed to feel that Mills' 1963–66 period was tainted because Mills in each of those years was subject to renegotiation. By adopting an historical norm, we do not imply that the clearance given those years indicates necessarily that only a reasonable, or competitive, profit was earned by plaintiff. Indeed, to the extent profits during those years exceeded the level necessary to prevent Mills from entering other markets, and, as such, arguably exceeded the competitive level, such excess would be continued in the review years.

[8] It is unnecessary to decide the binding nature of these regulations in a de novo proceeding in this court. *See Mason & Hanger,* 207 Ct. Cl. at 122, n. 13, 518 F.2d at 1351, n. 13. *Cf. Camel Mfg. Co v. United States, ante* at 460. (Renegotiation Board ruling, even if reasonable, held not conclusive upon court).

[9] The longer period is more akin to the period accepted in traditional financial analyses. We also take note that there were no years, prior to the review years, that were better than these, and that 1966 seems to be particularly favorable to Mills.

[10] The second numbered statutory factor specifically requires profits to be considered in relation to net worth. 50 U.S.C. app. § 1213(e)(2).

the sales and beginning net worth of each review year yields the following results:[11]

Year	Sales		Sales ratio: Historical Rate of Return		Base Period Level of profits
1967	13,376,000	×	7.95%	=	1,063,392
1968	10,256,000	×	7.95%	=	815,352
1969	11,346,000	×	7.95%	=	902,007

Year	Actual Profit	Less	Base Period Level of Profits		Variance between base & review years
1967	1,827,600	–	1,063,392	=	764,208
1968	1,466,170	–	815,352	=	650,818
1969	1,252,250	–	902,007	=	350,243

[11] Renegotiation Board regulations provide that the amount of net worth employed, as a general rule, will be that existing at the beginning of the fiscal year. Where there have been significant changes in any particular year, an average of the beginning and ending values may be more indicative of the amount of plaintiff's equity than the beginning value taken alone. *Aero Spacelines, Inc. v. United States*, 208 Ct. Cl. 704, 747, 530 F.2d 324, 350 (1976). Mills had considerable changes in net worth between the beginning and the end of 1967. Beginning net worth was $1,563,902 and ending net worth was $2,425,476. In view of the significant change in net worth during 1967, it may be appropriate that adjustments be made to reflect the amount employed during the year by adopting the average net worth for fiscal year 1967, or $1,994,675. This amount is largely, but not entirely, exclusive of nonbusiness related investments because it was agreed that the amounts and timing of nonbusiness related investments in 1967 necessitated special adjustments. As a result of these adjustments, the 1967 closing business related net worth was $2,425,476. Were we to ignore both these nonbusiness investments and the addition to net worth during 1967, beginning net worth would be $1,563,902, resulting in a variance of $898,380. The adjustments are favorable to Mills.

	Beginning		Net Worth Ratio Historical Rate		Base Period Level
Year	Net Worth		of Return		of profits
1967	1,994,625[11]	x	58.7%	=	1,170,874
1968	2,014,000	x	58.7%	=	1,182,218
1969	2,539,000	x	58.7%	=	1,490,393

	Actual		Base Period Level		Variance between base & review
Year	Profit	Less	of Profits		years
1967	1,827,600	-	1,170,874	=	656,726
1968	1,466,170	-	1,182,218	=	283,952
1969	1,252,250	-	1,490,393	=	(238,143)

[Footnote 11 appears on p. 555.]

Both of these ratios serve different functions and obviously they can lead to differing results. The profit-to-sales ratio shows profitability in relation to the dollar volume of business done. As an analytical tool, it is especially useful in those types of businesses that are not capital intensive, where there is a rapid turnover of expensive retail inventory, or where a significant portion of the facilities or materials are furnished by the Government or the customer. Contrarily, rates of return on net worth and on capital employed relate profits to the value of total assets and investments employed in the business and

provide a convenient way to measure profits on the owners' financial commitment to company business. Thus all nonbusiness related investments are excluded from the computations on net worth. The ratio of profit to net worth is most useful to measure profitability when the business requires an extended period to recover its costs. Its utility is less when a substantial part of the plant and materials comes from government-furnished facilities or government-furnished property and the owners provide essentially management functions. Generally, investment ratios have limited utility in businesses where capital accounts for a minor part of volume and profit in relation to the personal services involved in management and organizational functions.

While both ratios are to be considered, these considerations require our giving slightly greater weight in this instance to the profit-to-sales ratio.[12] First, plaintiff specifically refers to itself as a non-capital intensive industry. Brief at 31. Secondly, the issue in this case largely concerns the increased volume produced during the review years. Since fixed productive assets would not change significantly and since we are told that the increased volume was largely the result of increased utilization of assets, the primary input for this increased volume would be increased managerial skill. Our concern with the increased volume would make profitability in relationship to dollar volume of business the more significant standard. The profit-to-sales ratio most accurately reflects these concerns. Thirdly, although the net worth ratio excludes most of the investments made by Mills outside the parachute business, the ratio still includes a significant amount of cash on hand. Although some cash on hand is necessary to run any business, significant amounts of such cash will not measure profits on the owners' financial commitment to company business, which is one of the prime reasons for using the net worth ratio.[13] Finally, as seen in the above calculations,

[12] The trial judge, while agreeing that both ratios must be considered, adopted the profit-to-net worth ratios when making comparisons with other firms and never specified why the profit-to-sales ratio was unacceptable.

[13] Our calculations from defendant's table on use of profits, *see infra*, indicate that cash on hand constituted almost 38% of the net worth for 1967, 39.45% for 1968 and 26.8% for 1969.

a significant increase in net worth over a year may require using an average of the beginning and ending net worth for that year, a process which indicates less than complete confidence in the figure chosen. Moreover, each succeeding year's ratio builds upon the previous year's addition to net worth, whose very size may also be an indication of excessive profits being made in the year of addition. Since the previous year's addition to net worth may have been made partially, at least, from profits that were excessive, the profit ratio for the succeeding years' net worth may be artificially low because the net worth base was mistakenly high. The difference in ratios will become important in the discussion of intra-industry comparisons, *infra*.

IV.

Of the statutory factors, 50 U.S.C. app. § 1213(e), the most important in this case is the one concerning efficiency. Were we to find that Mills did not warrant favorable consideration for efficiency due to its control of variable costs during the review years, our decision would be much simpler. In *Gibraltar Mfg. Co. v. United States*, 212 Ct.Cl. 226, 546 F. 2d 386 (1976), the Government principally relied on an historical norm analysis to carry its burden of proof.[14] For the first year under review, production tripled largely as the result of the contractor's use of multiple shifts. While finding favorable recognition for efficiency was due plaintiff for its exceptional effort, 32 C.F.R. §§ 1460.10(b)(3), 1460.9(b) (1976), the court found that the evidence, particularly the historical norm analysis, indicated that plaintiff had realized some excessive profits. *Id.* at 239, 546 F.2d at 393. We would find similar considerations convincing in this case were it not for Mills' claim that it also deserves credit for its tight cost controls indicating increased efficiency, a claim not presented in *Gibraltar*.

Thus it becomes crucial whether Mills' increased profitability during the review years can be attributed largely or

[14] In *Gibraltar*, the pre tax profit-to-sales ratio was 15.18%, while the average return during the historical norm was 6.01%; here the average historical return is 7.95%, while the review year returns are 13.7%, 14.3% and 10.5% respectively.

entirely to an increase in efficiency. The parties have stipulated that the Company was one of the most reputable and efficient parachute manufacturers during both the base and the review periods. The Government contends that Mills failed to increase its efficiency during the review years and that this failure, in a period of stable or decreasing prices, leads to the conclusion that Mills' increased profits resulted from the lower unit costs caused by both the spreading of its fixed costs over the doubled volume of wartime production, and by changes in its product mix in favor of the less complex flare parachute. Both causes would be the direct result of the Government's wartime demand, entitling the Government to share in the increased profitability. 32 C.F.R. § 1460.10(b)(3) (1976). Implicit in the Government's position is the postulate that favorable recognition for efficiency cannot be given if a relative increase in the firm's efficiency cannot be shown during the review years. The trial judge interpreted the Renegotiation Act as not requiring such an increase in the contractor's efficiency during the review years. Nevertheless, he found that Mills had in fact increased its efficiency during that period. Two factors formed the basis of that opinion: (1) increased utilization of plant through use of multiple shifts; and (2) maintenance by Mills of both quality production and control of overhead costs during substantial changes in sales volume.

We have often noted the essentially comparative nature of the renegotiation process. *See, e.g., Major Coat,* 211 Ct.Cl. at 9, 543 F.2d at 102. Comparisons are of two types—those made with the firm's own prior history and those made with other outfits within the industry, adjustments being made for both qualitative and quantitative differences. 32 C.F.R. § 1460.10(b)(1) (1976). When we compare Mills' review year profitability with its prior profitability we are concerned, under the statutory factor of efficiency, with increases in its efficiency during the review period. To the extent the firm is equally efficient, however measured, in the base and review years, we would expect the profitability of the base years to incorporate an adequate return for

that level of efficiency.[15] Plaintiff's acceptance of the 1964–66 period as one of relative normalcy seems to us to concede as much. Similarly, the profitability of the base period indicates, to some extent at least, how the marketplace rewarded Mills for its efficiency vis-a-vis its competitors; again, plaintiff's acceptance of the 1964–66 period provides no reason for us to doubt this. Our concern with changes in the level of efficiency during the review years is not new; it is the necessary result of the recognition that efficiency in some absolute sense does not exist in any business, *Major Coat, id* at 34, 543 F.2d at 116, but is a comparative concept. We have already endorsed the principle of crediting, in general, only increases in the statutory factors. In *Major Coat, id* at 37, 543 F.2d at 117–18, compensation for the risks common to all compared firms was not merited because those risks would have been internalized in the firms' profit figures. Having asserted that we are primarily concerned with changes in efficiency, we hasten to add some qualifications. First, it is clear that under prior decisions of this court, *see Lykes Bros. S.S. Co., v. United States,* 198 Ct. Cl. 312, 459 F.2d 1393 (1972), it cannot be plaintiff's burden to establish an increase in efficiency. Once plaintiff has met its prima facie burden for such favorable consideration under this factor, it is the Government's burden to establish the lack of increased efficiency during the years under review. Secondly, concern with increases in efficiency should not result in undue emphasis upon base period averages, *A.C. Ball,* 209 Ct. Cl. at 263, 531 F.2d at 1015–16; *Major Coat,* 211 Ct. Cl. at 31, 543 F.2d at 114; wide variations in the years forming the average, or other considerations, might have to be noted and accounted for.

The first asserted basis for crediting Mills with increased efficiency is the more intense utilization of plant through use of multiple shifts. By itself, increased utilization of plant is not an increase in efficiency. Although the Board's regulations under this factor indicate favorable consideration is due for "exceptional effort," 32 C.F.R. § 1460.10(b)(3)

[15] Indeed, application of the historical rate of return over a doubled volume of sales may provide an added recovery for Mills.

see Gibraltar, 212 Cl. Ct. at 237–38, 546 F.2d at 393, it is difficult to put much weight on increased utilization alone, since any increased volume of production during short periods of time will be achievable primarily through increased utilization of assets. Significant credit for such increased effort requires more than a mere increase in asset utilization.

Intensive asset utilization, however, does evoke increased efficiency if the contractor is able to control diseconomies resulting from the attempt to produce more volume from a fixed asset base; this is the second of the asserted bases for finding increased efficiency. The ability to decrease controllable costs, or to even maintain them at an absolute or relative level of stability as production increases may very well indicate increased efficiency. *See Major Coat*, 211 Ct. Cl. at 35–36, 543 F.2d at 117. The contractor's ability to control costs will be best measured by comparisons with the firm's prior history or with the contemporaneous experience of comparable firms. The failure of Mills during the base period to increase its sales so greatly or to sell at a volume as high as that reached during the review period limits our ability to make meaningful comparisons with its prior history. Comparison of Mills' overhead as a percentage of sales with that of Mills' competitors, however, indicates a probable increase in efficiency by plaintiff during the review years. Specifically, the trial judge found that controllable expenses included in Mills' "other costs" were kept at lower levels than by other parachute manufacturers producing comparable volumes:

"Other Costs" As % Of Sales—Mills and Competitors

	Year			
Company	*1965*	*1967*	*1968*	*1969*
Mills	8.8	7.4	9.6	9.4
M. Steinthal	12.9	10.5	12.5	18.5
Pioneer Aerodynamic Systems	15.1	21.1	27.4	29.3
Switlick	16.7	19.9	22.7	11.7*
Pioneer Parachute Co.	31.4	35.2	38.9	30.0

*Loss year

The relevant comparison, we note, is not with the absolute values of the above percentages, but with their change from the base period. Thus in 1965, a year of less than average profitability for Mills, its cost remainder was a full 32% less than the nearest competitor here shown. To the extent that this differential is due to tighter control of variable costs, the profits of that concededly normal year should take this into account. In 1967 and 1968, the differential between these two companies remained about the same; indeed in 1968, plaintiff's ability to control these costs vis-a-vis this competitor declined relatively by 8% over the 1965 period. But by 1969, the review year of least profitability, Mills was able to control its variable "other costs" so that they were only about 50%, as a percentage of its sales, of its nearest competitor's (here shown).

Conspicuous among the firms not shown in the above table, are two that provide significant intra-industry comparisons: Automotive Textile Products and Security Parachute. They show the following:

	1966	*1967*	*1968*	*1969*
Mills	8.8	7.4	9.6	9.4
Automotive Textile	7.9%	6.3%**	8.5%	10.9%
Security Parachute		12.1%**		

**Year found to contain excessive profits.

As compared to Mills in both absolute and relative terms,[16] Automotive was able to control its costs better than Mills in 1967 and 1968,[17] but not in 1969. Furthermore, the low level of the "other costs" in 1967, and the large reduction from the previous year, did not preclude the Renegotiation Board's determination that Automotive Textile had earned excessive profits of $400,000 on sales that would have to be increased 2½ times to equal those of Mills' in the same year.

There are, of course, difficulties with this analysis which tend to be stressed by the party feeling most harmed by the data. The data is unaudited. Only one base year was involved and individual companies are being compared. "Other costs" include fixed costs which do not change as the production volume varies and which, not being continuously controllable, are not as indicative of efficiency. The percentages do not account for variances in the sales volumes of the companies or the rate of increase of the volumes on the fixed asset base. For example, Mills' ability to keep costs as a percentage of sales at 9.6% might be more significant if its sales had doubled on a fixed asset base while other firms attempting to so double their

[16] In 1966, other costs of Automotive were 10.2% less than Mills' other costs. By 1967 this had increased to 14.9% and in 1968 it was still 11.5% less than Mills. We recognize that these percentages are of sales and that the two firms had different sales volumes through these years. As such we do not put great weight on the fineness of the differences in the above percentages. They do however provide valuable, but rough, insight into comparable efficiencies.

[17] The base year here compared with is 1966 because Automotive Textile did not make sufficient sales in this market to be subject to the Renegotiation Act in 1965. Mills' other costs as a percentage of sales were identical to its 1965 figure of 8.8%. We recognize the difficulty in making the switch in base years and appropriately discount the weight we give these numbers.

volume had significantly larger relative increases. Alternatively, the constancy of the percentage ratio may be deceptive because a doubling of an already large sales base permits a large absolute increase in these other costs before the percentage level increases.

Defendant, having the ultimate burden of proof in renegotiation, must bear the adverse implications of the thinness of the comparative data, unless the absence of data were the contractor's responsibility. The above data is less conclusive than we would desire; it certainly does not establish that Mills does not merit favorable consideration for increased efficiency during the review years. On the whole we are favorably impressed by Mills' ability to control its costs when compared with several members of its industry, and we are sensitive to the Renegotiation Act's emphasis on the control of these costs. But we conclude, nevertheless, that the Government has established that Mills' increased profits were not entirely the result of its increased efficiency. Thus, we find that Mills merits favorable consideration for efficiency but are not persuaded that its efficiency precludes the possibility of its having earned excessive profits in the circumstances of this case.

V.

Defendant undertook a profit-use analysis in order to verify its conclusion that the bulk of plaintiff's increased profits was due to economies of scale rather than considerations meriting credit under the statutory factors. It is not disputed that Mills' gross nonparachute business investments grew substantially during the review years. They were $20,444 in 1966; in 1967, they increased to $660,044, and by 1969 they were $1,055,651. When Mills' cash on hand is also considered, the results are even more dramatic:

Year	Cash On Hand	External Investments	Total	Percentage Of Total To Net Worth
	(1)	(2)	(1+2)	
	(000)	(000)	(000)	
1966	$ 125	$ 23	$ 148	9%
1967	957	660	1,617	64%
1968	1,266	820	2,086	65%
1969	1,005	1,056	2,061	55%

In the review period, Mills also retained from its earnings and added to its parachute business a total of $2,157,000. Additions to Mills' beginning net worth in the parachute business averaged 27.9 percent annually in each of the review years.

Although such evidence does not establish in itself that Mills fails to merit favorable consideration under the statutory factors, the sheer magnitude of the cash on hand, the annual increases in net worth, and the external investments during wartime procurement, all cause us to (1) be less certain of the extent of favorable consideration given under the particular statutory factors, and (2) be more hospitable to the idea that plaintiff's profits during the review years arose, not from factors for which it was responsible, but from wartime conditions which tend to enhance its gain.

VI.

As we have pointed out, the Government's case rests principally upon its historical norm analysis. Two other tests were used by the Government to buttress its claim that excessive profits had been earned—a break even analysis and a product mix analysis. The trial judge rejected both of these analyses, and we shall mention them but briefly.

An essential quality of firm, fixed price contracts is that the contractor assumes responsibility for his costs, with the inevitable risk that greater costs than anticipated will be incurred and that a loss on the contract can result. *A.C. Ball*, 209 Ct. Cl. at 248–49, 531 F.2d at 1007; 32 C.F.R. § 1460.12(b)(1) (1976). Yet the assessment of risk is essentially a comparative exercise. The presence of risks common to all firms will not entitle the contractor to more or less profit than is merited by an otherwise comparable firm; compensation for those risks, to the extent the market will permit, should be already internalized in the comparable firm's profit figure. Thus favorable recognition must require an increased assumption of risks, as it did with efficiency. *Major Coat*, 211 Ct. Cl. at 37, 543 F.2d at 117–18. Defendant's break-even analysis was an attempt to measure the extent of risk Mills assumed when it responded to invitations for bids on government parachutes by determining the level of sales needed to recover continuing fixed costs. Once that level was reached, recovery of direct costs would be the major element of risk in accepting additional business. Mills would thus, it is said, have a great degree of flexibility in selecting the type of solicitations to which it wished to respond and in pricing its bids for government business; any price that was above the direct cost of material and labor would yield profits. Essentially the analysis attempts to indicate at what point in time one less variable need be accounted for in bidding and accepting new contracts.

The data is simply too sparse to support this theory. Similar data from comparable firms is lacking, precluding appraisal of Mills' relative risks; earlier break-even points in 1967 and 1968 than in 1965 and 1966 may be more the result of Mills' ability to control variable costs, other than direct costs for material and labor, over a vastly expanded volume of production; the earlier points may simply be the result of an expanded volume, or of changes in Mills' product mix, with some types of parachutes contributing more to profits and overhead; or they may be the result of any combination of these factors. The trial judge rejected the analysis because there also was no evidence that Mills was either cognizant of or utilized the flexibility claimed by

this analysis. While we are less sure that the standard is completely subjective, *cf. Major Coat, id* at 38, n.7, 543 F.2d at 118, n.7 (risks must be more than speculative to be considered), our end-appraisal of the weakness of the analysis is the same as the trial judge's. Since plaintiff has neither introduced evidence of, nor claimed recognition for, increased risks during the review period, any risks Mills undertook will be compensated through use of the historical norm as a starting point and through intra-industry comparisons.

The defendant's product-mix analysis also fails in this instance to provide adequate support for its claim that Mills earned excessive profits in the review years. In that analysis defendant's expert contended that the increase over previous years in the percentage rate of Mills' contribution to profit and overhead for the years 1967–69[18] was due either to an increase in Mills' efficiency, to increased prices, or to a change in the mixture of types of parachutes manufactured and sold. After concluding that there was no increase in Mills' efficiency and that prices remained relatively stable, defendant's expert contended that, in Mills' case, some products contributed more to overhead and profit than did others and that the increase in the percentage rate of Mills' contribution to profit and overhead was attributable to the increases in volumes of the simpler flare parachutes in the review period.

Our finding that Mills in fact increased its efficiency casts much doubt on the validity of the analysis. Furthermore, a proper analysis would determine the unit costs of the various categories of parachutes so that the effect on costs and profits of varying the product mixes could be measured. Were this test more central to our decision, we might consider the Government's asserted inability to perform a proper analysis because Mills did not keep detailed cost accounting data.[19] As it is, we put aside for

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[18] The rates, calculated in defendant's break-even analysis, were: 16.9% (1965); 18.4% (1966); 21.1% (1967); 23.6% (1968); 20.1% (1969).

[19] *Cf. Camel Mfg. Co. v. United States*, (burden of proof, and thus the risk of nonpersuasion, for accounting data placed *ante* at 480, 484, upon contractor).

this case the product-mix test, resting our decision on other factors and considerations.

VII

Initially, plaintiff sought to evaluate Mills' performance through comparisons with commercial textile fabricators, relying upon Board Regulations 32 C.F.R. §§ 1460.2(c) and 1460.10(b)(1) (1976). The trial judge found differences with these companies significant enough to preclude their comparison with Mills' operations for the purposes of renegotiation. Mills does not dispute this decision, nor do we. The trial judge's comparison was limited to other government parachute suppliers, and it was discovered that the post-renegotiation returns on net worth and capital of two competitors exceeded the pre-renegotiation ratios of Mills for the review years. Specifically, in 1967, Mills had a return on beginning net worth of 116.9 percent and on average net worth of 91.6%. In that year, Automotive Textile Products Co., Inc., had its initial return on net worth of 350 percent reduced to 188 percent after renegotiation; Security Parachute Company had its return on net worth of 264 percent reduced to 219 percent. (Comparable information is not available for any other parachute manufacturers.)

Defendant's response is an elaborate argument to the effect that comparisons cannot be made with other members of the parachute industry because that data reflects the noncompetitive conditions in the entire market brought about by the increased wartime demand. As proof that noncompetitive conditions existed, defendant presented evidence of a higher profit ratio on an expanded sales volume for the entire industry, and relied upon a statement in *Major Coat*, *id* at 23, 543 F.2d at 110, that such a rise *may* show the absence of competition.

The Government's argument misses the full significance of the comparisons made by the trial judge.[20] It is true that

[20] Earlier we argued that there may be strong indications of the absence of competition in the parachute market. Such arguments were presented in rebuttal to the proposition that the method of bidding for these contracts assured, at least presumptively, the presence of a reasonable profit. They fell far short of establishing the absence of competitive factors sufficient to preclude use of any intra-industry

measuring the reasonableness of a contractor's profits against the noncompetitive profits of others is futile. *Major Coat, id* at 23–25, 543 F.2d at 109–10, 111. Indeed, in *Major Coat,* the court found that the potential imperfections in the market caused by wartime demand and consequent pressure on industrial capacity, evidenced by the use of rated orders, precluded comparing that contractor with other firms producing the same product. Here, however, comparisons have been made only with the after-renegotiation profit rates of other parachute manufacturers.[21] The post renegotiation profit figures supposedly remove any excessive profits realized in the firms' review years and thus theoretically provide a standard against which Mills' review year performance can be measured. *Major Coat id* at 43, 543 F.2d at 121. The demonstrated closeness of the underlying firms' operations and risks to those of Mills make these figures even more probative of what a comparable competitive profit would be. *Id.* at 42, 543 F.2d at 121. One difficulty, however, in our use of these figures is our lack of knowledge of what information was before the Board and what changes, if any, it made in accepting profits at these levels. Yet plaintiff's own introduction and acceptance of the reasonableness and comparability of these profit figures to its own competitive earning power, *id.* at 47, 543 F.2d at 123, justify the comparison.

When we compare the post-renegotiation profit-to-sales ratios, which we have found to be the more significant ratio in this case, of these two competitors with Mills' sales ratio, the results differ from those previously noted. Automotive Textile had its pre-renegotiation profit to sales ratio of 16.2 reduced to 9.4; Security Parachute's ratio was reduced from 16.4 to 14.0. Mills' pre-renegotiation ratios for the 1967–69 review period are 13.7, 14.4 and 10.8 respectively. Were we merely to average the after-renegotiation ratios of these

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comparisons during the review years.

[21] This proceeding is *de novo,* and the prior decisions of the Renegotiation Board are not conclusive. The suggestive use of the Board's judgment, however, is permitted and does not prejudice the de novo character of this proceeding. *Gibraltar Mfg. Co. v. United States,* 212 Ct. Cl. 226, 229, 546 F.2d 386, 388 (1976).

two firms (*i.e.* a sales ratio of 11.7), some refunds for 1967 and 1968 would appear in order. Were we forced to place greater emphasis upon one firm's ratio than the others', we would note that Automotive Textile had previous and subsequent years subject to renegotiation, while Security Parachute has had only this year with sales in the parachute market above the statutory minimum. Furthermore, Automotive Textile was able to control its other costs even better than was Mills and would presumably have deserved even greater credit for efficiency. Use of the 11.7 sales ratio would result in excessive profits for Mills of $293,400 in 1967, and $297,900 for 1968. Use of the 9.4 sales ratio would amount to excessive profits of $628,800 for 1967, and $554,000 for 1968.

VIII

The Government has persuaded us that Mills earned profits during the review years that were excessive. Evidence of wartime market imperfections has precluded our accepting the reasonableness of Mills' profits from the competitively bid nature of its procurement. The historical norm analysis, whose base period was essentially conceded to be one of relative normalcy by Mills, provides our starting point. From there we assessed whether consideration under the various statutory factors was already encompassed within that norm or whether additional consideration was merited. Mills' risks were found to be already adequately compensated through use of the historical norm and through intra-industry comparisons, but some additional favorable consideration was found due for Mills' increased efficiency in cost control. But we noted also, that a comparable firm found to be equally efficient was held to have earned $400,000 in excessive profits for 1967. We have considered all the remaining statutory factors and find them to be either adequately compensated by application of the historical norm and intra-industry comparisons, or not claimed here, or not pertinent to the facts of this case. As we see it, economies of scale caused by the increased volume of production during wartime competitive dislocations, changes for which Mills was not

responsible, were partly responsible for the company's increased profitability during the review years. In short, the tremendous increase in wartime demand, the evidence of market imperfections, and the size of the increase in external investment, cash on hand, and additions to net worth, when combined with the difference in Mills' earnings and those of firms which Mills introduced as comparable, convince us that Mills earned excessive profits in 1967 and 1968. For 1969 we hold that no excessive profits were earned.[22] The court has indicated that the determination of the amount of excessive profits is very far from an exact science and that, very often, a broad-brush technique or general estimate is called for. *See A.C. Ball Co. v. United States*, 209 Ct. Cl. at 229–30, 531 F.2d at 996; *Dynasciences Corp. v. United States*, 214 Ct. Cl. 643, 669 (1977).[23] in this instance our best judgment on the whole case is that plaintiff earned $425,000 in excessive profits in 1967 and $350,000 in 1968. This holding puts Mills' profit-sales-ratio at 10.8 for 1967 and 11.3 for 1968, figures which compare favorably with its competitors and are not ungenerous when compared with the company's previous history. For 1969, as we have said, we grant a clearance.

CONCLUSION OF LAW

The court concludes as a matter of law that for the 1967 and 1968 fiscal years plaintiff realized excessive profits in the gross amount of $425,000 and $350,000 respectively, from contracts and subcontracts subject to renegotiation under the Renegotiation Act of 1951, as amended. For those years, judgment is hereby entered on defendant's counterclaim in the sum of seven hundred seventy-five thousand dollars ($775,000) less appropriate state and federal tax credits, plus interest thereon as provided by

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[22] It should be remembered that (a) under the net-worth ratio 1969 would be a clearance year, (b) in 1969 Mills apparently controlled its costs better than in the other review years and better than its main competitor, and (c) under the profit-sales formula, Mills' ratio for 1969 was less than that of the average of its two prime competitors.

[23] In *Major Coat*, 211 Ct. Cl at 48, 543 F.2d at 124, we also indicated that, in a case like this, we would for a limited time not hold the defendant rigidly to the strict standards of proof theoretically called for by *Lykes*.

Syllabus

law. The court also concludes that the plaintiff realized no excessive profits from contracts or subcontracts subject to renegotiation during its fiscal year 1969; with respect to that year defendant's counterclaim is dismissed.

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571 F. 2d 546

DAVID B. LILLY COMPANY, INC., FOR ITSELF AND AS SUCCESSOR IN MERGER TO DELAWARE FASTENER CORP. v. THE UNITED STATES

[No. 332-77. Decided February 22, 1978]

ON DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT

Renegotiation of contracts; validity of Renegotiation Board orders; quorum of Board members; finality of orders; delegation of powers.—This phase of the dispute is before the court on a stipulation of facts. Plaintiff has been engaged in renegotiation proceedings with respect to its fiscal years 1967, 1968 and 1969. In connection with these proceedings, a duly constituted quorum of the Board met on February 1, 1977 and four Board members, by unanimous vote, determined the amount of excessive profits, approved a proposed final opinion, and directed the chairman to mail the opinion, together with unilateral orders reciting each fiscal year's determination, to plaintiff. On or about March 4, 1977 three of the Board members resigned. On March 15, 1977, before appointment of new Board members, the Board chairman signed and mailed the orders to plaintiff. Plaintiff contends that the orders are invalid for lack of a quorum on the date they were signed and mailed. It is *held*, for the limited purpose of determining the validity *vel non* of the orders, that they became "final" on the date the Board's deliberative process concluded. It is further *held* that the subsequent actual issuance of the orders had been properly delegated to the chairman and that a quorum was not necessary on the issue date. Defendant's motion for partial summary judgment is granted, and the corresponding part of plaintiff's petition is dismissed. The case is remanded to the trial division for further proceedings on the remainder of the petition.

Renegotiation of contracts; Renegotiation Board; quorum; finality of orders.

[1] Where a duly constituted quorum of the Renegotiation Board determined, by unanimous vote, the amount of excessive profits, approved a final opinion, and directed the chairman to mail the opinion and implementing orders to the contractor, and where the Board did not amend the opinion and its membership remained unchanged during the 5-day period for concurrence or dissent established by the Board, 50

Opinion of the Court

U.S.C. App. § 1217(b) is satisfied since a quorum existed during the deliberative process. The orders became final for the limited purpose involved here when the Board concluded its deliberative process, notwithstanding that the orders were not issued later after certain members of the quorum had resigned.

War and National Defense ⊂59

Renegotiation of contracts; Renegotiation Board; delegation of powers.

[2] Where a quorum of the Board determined the excessive profits, rendered and approved the final opinion, and directed the chairman to issue and mail implementing orders in the amount determined, delegation of the merely ministerial acts occurred at that time. Such delegation is consistent with the statutory language, with Board practice and is supported by common sense. The fact that the delegation was not exercised until after the full quorum no longer existed does not defeat the delegation.

War and National Defense ⊂59

Burton A. Schwalb, attorney of record for plaintiff. *Arent, Fox, Kintner, Plotkin & Kahn*, of counsel.

Bernard M. Brodsky, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, NICHOLS, KASHIWA, KUNZIG, and BENNETT, *Judges, en banc.*

KUNZIG, *Judge*, delivered the opinion of the court:

The sole question in this Renegotiation Act case is whether certain orders of the Renegotiation Board (the Board) are valid. Plaintiff, by petition filed in this court on June 10, 1977, alleges (among other asserted grounds, not now before us, for upsetting the Board's determination) that the Board's orders are invalid for lack of a quorum on the date they were signed and mailed. Defendant now moves for partial summary judgment on that question alone. We find on the stipulated facts that four members of the Board, by unanimous vote, determined the amount of excessive profits, approved the final opinion, and directed that the orders be issued. We hold that, for the limited purpose of determining the validity *vel non* of the orders, they became "final" on the date the Board's deliberative process concluded which, in this case, occurred not later than February 6, 1977—five days after the vote. We

further hold that the subsequent actual issuance of the orders had been properly delegated to the chairman of the Board and that a quorum was not necessary on the issue date.

There is no dispute as to the facts in this case. Plaintiff has been engaged in renegotiation proceedings with respect to its fiscal years 1967, 1968, and 1969. In connection with these proceedings, a duly constituted quorum[1] of the Board met on February 1, 1977. The minutes reflect that four Board members determined the amount of excessive profits, considered and approved a proposed final opinion, and directed that the opinion be mailed to plaintiff, together with unilateral orders reciting each fiscal year's determination (adjusted for appropriate tax payments). Subsequently, on or about March 4, 1977, three of the Renegotiation Board members resigned. On March 15, 1977, after the resignations and before new members had been appointed, Chairman Chase signed and mailed the orders, as previously directed, to plaintiff.

Plaintiff brought suit initially in the U.S. District Court for the District of Columbia contending that the Board orders are a legal nullity because of the absence of a quorum on March 15, 1977. The District Court suit was dismissed on June 9, 1977 on the grounds that the Court of Claims has exclusive jurisdiction over the cause. Plaintiff then filed suit in this court, again asserting that the orders are invalid and joining to that claim certain other substantive exceptions not presently before the court. Defendant moved for partial summary judgment, limiting its motion to the sole issue of whether the Board's orders are valid.[2]

Plaintiff argues that the Renegotiation Act of 1951, as amended, (the Act) provides that the Board must perform its functions through a quorum of three of its members. 50 U.S.C. App. § 1217(b) (1970). On the stipulated facts of this

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[1] The Board consists of five members; a quorum consists of three. 50 U.S.C. App. § 1217(a) & (b) (1970).

[2] This case was previously before the court on defendant's motion for expedited briefing and decision (August 2, 1977 being the last possible date for renegotiation for the fiscal years involved in this case). The Motion for Expedited Briefing and Decision was denied by this court on July 12, 1977.

case, plaintiff contends, these orders were not issued until March 15, 1977, at which time a quorum of three did not exist. Plaintiff urges that the orders are not final until issued, that the Board cannot delegate its power to issue orders, and, therefore, that the orders are void.[3]

Defendant concedes that the orders were not issued until March 15, 1977, but focuses our attention on the Renegotiation Board meeting and vote of February 1, 1977. Defendant argues that since the Board acted through a quorum on February 1 and did not alter or amend the orders within the next five days, those orders issued on March 15 are valid. Board practice, defendant notes, is that the chairman signs the orders. Defendant urges that such practice is a permissible delegation of ministerial acts after the deliberative process has ended and that no quorum is necessary on the date that the chairman merely signs orders as previously directed.

We agree with defendant and hold that these orders are valid. The orders became "final," for the limited purpose involved here, when the Board concluded its deliberative process. The issuance was properly delegated by the Board to its chairman and no quorum was necessary on the date of issue.[4]

The focus of our analysis should be directed initially to the administrative fact-finding and adjudicative process (the "deliberative process"). The language of the controlling statute states:

> . . . Three members of the Board shall constitute a quorum, and any power, function, or duty of the Board may be exercised or performed by a majority of the members present if the members present constitute at least a quorum. 50 U.S.C. App. § 1217(b) (1970).

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[3] If void, plaintiff asserts, this court would have to call for additional briefing on the validity of certain "Ratification and Contingent Orders" (*see* note 4, *infra*) which the Board issued later.

[4] We have learned, from defendant's response brief, that the orders in question have been again issued, as "Ratification and Contingent Orders," on July 29, 1977 (there being a quorum on July 29). This prudent effort to preserve the Board's power to act should this court have decided the other way (the last date for renegotiation in this case was August 2, 1977) does not render the question moot. The July 29 ratification does not, by its terms, become effective unless and until the earlier orders are found to be invalid by a court.

Thus, if a quorum exists at the time the deliberative process is completed, the language of the statute is satisfied, the Board *has* exercised its "power, function, or duty" *at that point.* Our concern (and that of the statute) is with the integrity of the deliberative process through which the Board acts. Plaintiff has a right to present his claim to a quorum of the Board; he did so. A quorum of the Board must fully consider the claim; it did so. The statute requires no less, but neither does it demand more. Plaintiff has had a full and fair hearing; and one such hearing is certainly sufficient. To hold otherwise would go beyond the words of the statute, would exalt form over substance, and would create a real likelihood of administrative chaos not to mention the potential for manipulation of results. All this in a situation where plaintiff has suffered no injury.

In the instant case, the deliberative process was complete either upon the date of the vote (February 1, 1977) or upon the expiration of five days thereafter (the Board follows an internal memorandum which limits the time for Board member comments concurring or dissenting to five days. Memorandum from Assistant General Counsel-Secretary to Chairman of Renegotiation Board regarding instructions on preparation of minutes.) Because there was a quorum on both dates, it is sufficient for us, to uphold these orders, merely to find that the Board completed its action on or before February 6. Since the parties have agreed that the Board acted on February 1, and since we hold that the deliberative process was concluded no more than five days later, it follows that the orders are valid. *See Braniff Airways, Inc.* v. *C.A.B.*, 379 F.2d 453, 459 (D.C. Cir. 1967).

We emphasize that our holding is simply that these orders became valid on or before February 6, 1977. Plaintiff calls our attention to cases which involve judges changing their minds after preparing but before issuing opinions. In the instant case, however, the Board did not change its mind or its membership within the five-day period. Since, pursuant to its internal memorandum, neither the old Board nor the new Board could reverse the orders after the expiration of the five-day period, plaintiff's cases are inapposite.

Plaintiff vigorously argues that an order can become "valid" *only* when it becomes "final" for purposes of seeking overall judicial review. This argument is not well taken. Certainly, some knowledge of the substance of the orders must "to some extent be made manifest" for substantive rights to be defined and for the time for seeking review to begin to run. *Skelly Oil Co.* v. *Phillips Petroleum Co.*, 339 U.S. 667, 676 (1950).

Though that knowledge did not occur in the instant case until the orders were signed and mailed on March 15, 1977, such a consideration is not relevant here. Knowledge of the contents of the order or receipt thereof by the renegotiated contractor is totally immaterial to the problem we face here. What is important is the completion of the "deliberative process."[5]

We turn now to the remaining issue which is whether, once having acted through a quorum, the Board could then properly delegate the actual issuance of the implementing orders.

The same statute which provides that the functions of the Board be exercised by a quorum also permits of delegation:

(d) Delegation of powers.

> The Board may delegate in whole or in part any function, power, or duty . . . to any agency of the Government, including any such agency established by the Board, and may authorize the successive redelegation, within limits specified by it, of any such function, power, or duty to any agency of the Government, including any such agency established by the Board . . . . 50 U.S.C. App. § 1217(d) (1970).

Though admittedly, in this instance, the delegation was not accomplished by an actual, specific regulation, there is nothing to indicate that a regulation is necessary. When a quorum of the Board directed, at its February 1 meeting, that the orders issue, the delegation occurred then and there. Such delegation is consistent with the statutory

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[5] *See AFL-CIO* v. *Bingham*, No. 77-1516 (D.C. Cir., Dec. 7, 1977), slip op. at 9 and note 6 (determining the "validity *vel non* of an order" involves different considerations than those concerned in determining finality for purposes of seeking review).

language, with Board practice, and is supported by common sense.

Plaintiff insists that the Board cannot delegate its power to issue orders because such issuance requires the exercise of discretion. Plaintiff claims support for its position in the "extensive and elaborate" procedures used by the secretary in drafting orders pursuant to the Board's direction. But the elaboration and attention to detail in obtaining figures to be put in the blanks does not transform a ministerial act into something else.

The Board has not delegated its responsibility to determine the amount of excessive profit realized nor its responsibility to render the final opinion. What has happened here is that, after having determined the excessive profit and after having approved the final opinion, the Board left it to the chairman and secretary to issue the orders in the amount directed and to mail those orders. Neither the chairman nor the secretary did anything more than implement the February 1, 1977 Board directive.

Preparation of the orders, as explained by the Government's briefs and exhibits without contradiction, is an essentially mechanical function of filling in the blanks on pre-printed forms. The amount of excessive profit having been already fixed by the Board, the adjustment for taxes is automatically made by the staff, and the figures are entered. Though entry of the tax credit may be made with great care, it remains a function clerical in nature; the overall preparation of the form is standard and ministerial, hence capable of delegation. So is the mailing.

Nor is the delegation defeated, as plaintiff urges, by the fact that it remained unexercised until March 15—after the resignation of Board members who had made the delegation. We need not decide what might be the effect had the Board been dissolved completely. The Board is a continuing body and remained so throughout the period. In light of this circumstance, the assertion that the delegation was extinguished before implemented is simply untenable.

Accordingly, upon consideration of the briefs and exhibits, and after oral argument, defendant's motion for partial summary judgment is granted and the correspond-

ing part of plaintiff's petition is dismissed. This case is remanded to the trial division for further proceedings on the remainder of the petition.

NICHOLS, *Judge*, with whom BENNETT, *Judge*, joins, dissenting:

Respectfully, I dissent. In my view, this holding contravenes the well-known rule that no one can participate in the decision of a tribunal of which he is not a member on the effective date. That proposition will not be disputed, I suppose. It is well recognized in the practice of courts. Thus, one of our judges who voted for a decision or even prepared it would not be recognized as participating if he died before the promulgation date. It would issue on the authority of the survivors of the original panel, not that of the deceased member. In a different situation I observed the same rule at some personal inconvenience, having deferred my resignation from the Customs Court and my swearing into this court in order to permit four decisions of the former tribunal to issue and be valid. I never supposed I could resign and still have them come out under my name. Yet that is in effect what the resigned members of the Renegotiation Board are attempting to do here.

The court avoids a direct challenge to that rule by asserting that the effective date was, alternatively, February 1 or February 6. It is not denied that the statute fixes the final date for the purpose of taking appeal as the date of the order, here March 15. That is the date after which the order is "final," 50 U.S.C. App. § 1215(a)(1), that must occur within two years after "commencement," or any extension thereof, 50 U.S.C. App. § 1215(c), and that starts the running of interest, 50 U.S.C. App. § 1215(b)(2). The meeting and vote of February 1 is a useful and necessary preliminary, no doubt, but it is as unknown to the statute as our "decisions" conferences are to the judicial code. The court gets around this by saying that there can be two or more effective dates for different legal purposes and that the members then on the Board could authorize the order to be prepared and issued as a ministerial act. Of course, the court can conjure up any

number of effective dates if it chooses. No further action by the Board members was required, after February 6, and if they had remained in office, the signing and issue would indeed have been ministerial, but in my view, when done, it would have been their action, not that of the chairman alone who signed for them. With their resignations, it ceased to be ministerial. In a similar manner, in the period between our decisions conferences and our decision days, ministerial acts only are performed, namely, printing and proofreading, but still we all speak as of the date at the top of each opinion. The natural relationship of the Board's meetings with its promulgation dates would seem to be the same as ours. The scheme the court proposes is artificial and unnatural.

In oral argument we had much theory and discussion of hypotheticals. Defendant took the view it was forced by the logic of its position to take, that after February 6 the order was final in the sense that neither the old Board, had it remained, nor the new one, if appointed before March 15, could have stopped the promulgation and taken the case under reconsideration. It certainly would have shocked the hypothetical new board to be told the chairman had orders he was about to issue, as to which they had no say. They might well have asked how an order not yet issued could be final against them when by express statutory language it was not yet final against anybody else. In a more practical vein, they might have asked how they could explain to their disappointed admirers that a secret meeting, six weeks earlier, with a procedure unpublished and unknown, that allowed only five days for concurrence or dissent, had relieved them of all responsibility for whatever errors an order might contain, that was issued after they had ostensibly become full members.

It would be better practice, I think, if preparation of the order is as ministerial as alleged, to have it ready at or shortly after the Board votes on it, and put it out forthwith. But if situations like this are to recur, it certainly seems better to allow resignations and new appointments to have their natural and normal effect, for old members whose resignations are accepted, to cease immediately being responsible for anything done in the Board name thereaf-

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ter, and for the new ones to be fully responsible for everything done in the name of the Board thereafter. The disturbance of this natural order of things by assigning a specious finality to a vote at a secret and unpublished meeting, seems to me as ill advised practically as it is questionable legally.

It was suggested that new members might have difficulty acquainting themselves with old cases in the necessary time, and it was apparent, if its position prevailed, plaintiff was preparing to insist on reopening this case, while holding out on agreement to necessary extensions of time. It is to be remembered, however, that due process is not required in renegotiation at the Board level. The law would, I believe, look kindly on anything the Board might deem it necessary to do to prevent limitations running. To be more specific, I would have proceeded to consider the "Ratification and Contingent Orders" referred to in Judge Kunzig's footnote 4. We do not know what plaintiff can urge against them. I think we should have considered both sets of orders at once, but we did not. I can only say, therefore, that it would have taken a lot to convince me that the later set were invalid. As regards the practical outcome of this case, there is not much difference between the court and me, but my analysis I think would furnish a better guide for the future.

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572 F.2d 737

SUMMIT NURSING HOME, INC. v. THE UNITED STATES

[No. 89–74. Decided February 22, 1978]

ON THE PARTIES' CROSS-MOTIONS FOR SUMMARY JUDGMENT

Medicare contract; reimbursement for provider costs; accelerated depreciation; recapture of funds; retroactivity of regulation; constitutionality.—Plaintiff is a provider of services under the Medicare provisions of the Social Security Act. Plaintiff seeks to recover an amount for accelerated depreciation for fiscal years ending October 31, 1967 through October 31, 1971, which amount had been allowed and paid as a reasonable cost reimbursement to plaintiff for services and

Syllabus

then recaptured by defendant pursuant to 20 C.F.R. § 405.415(d)(3) (August 1970). Plaintiff contends that the retroactive application of the regulation was unconstitutional as contravening the due process clause of the Fifth Amendment and as a denial of equal protection of the law, and that the Secretary's action in recapturing the funds was unlawful and invalid. It is *held* that the retroactive application of the recapture provision of the regulation in plaintiff's case did not violate its constitutional rights, and that in view of the explicit statutory obligation imposed on the Secretary his actions in recouping the funds were lawful. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed. Plaintiff's request that its petition be treated as a class action is also denied.

Contracts; Medicare contract; cost determination; retroactive corrective adjustments.

[1] The retroactive corrective adjustments required by 42 U.S.C. § 1395x(v)(1) are not limited to a single prior fiscal period.

Social Security and Public Welfare ⚖241.10

Contracts; Medicare contract; cost determination; retroactive corrective adjustments.

[2] 20 C.F.R. § 405.415(d)(3) is mandated by 42 U.S.C. §1395x(v)(1)(A)(ii); it is reasonably related to the purpose of the enabling legislation; and it represents a determination by the Secretary resulting from the exercise of his economic judgment in an area committed to his expertise.

Social Security and Public Welfare ⚖241.10

Contracts; Medicare contract; cost determination; retroactive corrective adjustments.

[3] Neither 42 U.S.C. § 1395x(v)(1) nor 20 C.F.R. § 405.415(d)(3) requires that the Secretary, before making a retroactive adjustment, make a formal, separate finding that the prior method of reimbursing providers was inadequate or excessive.

Social Security and Public Welfare ⚖241.10

Regulation of Executive Department; retroactivity of.

[4] The fact that a regulation might have a retroactive effect does not necessarily render it invalid. If the mischief of producing a result contrary to a statutory design or to legal and equitable principles is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law. Here, since 20 C.F.R. § 405.415(d)(3) providing for recapture of excess accelerated depreciation allowances was mandated by 42 U.S.C. § 1395x(v)(1), recapture was not contrary to statutory design nor prohibited by 5 U.S.C. § 551(4).

Social Security and Public Welfare ⚖241.10

Statutes; construction and operation; administrative interpretation.

[5] Administrative agencies are required to follow a congressional mandate.

Administrative Law and Procedure ⚖305

Syllabus

Contracts; Medicare contract; cost determination; retroactive corrective adjustment.

[6] The Secretary had a right to issue 20 C.F.R. § 405.415(d)(3) in order to correct prior mistakes in the administration of the Medicare program, and the retroactive application of the recapture proceedings was required by 42 U.S.C. § 1395x(v)(1) to insure that the reimbursement provided by the Government will go to pay only for the costs of services to Medicare beneficiaries.

Social Security and Public Welfare ⚖241.10

Regulation of Executive Department; retroactivity of.

[7] Retroactive application of a regulation will not be declared unconstitutional unless after a balancing of the considerations on both sides, it is determined that the regulation is unreasonable. The strong public interest in the retroactive curing of a defect in the administration of government outweighs the individual interest in benefiting from the defect.

Constitutional Law ⚖190

Constitutional law; due process of law-Fifth Amendment; Medicare Act; retroactive corrective adjustments.

[8] The Secretary determined in a regulation that when a substantial decrease in the utilization of a provider's facilities by Medicare patients occurs, the continued allowance of accelerated depreciation at the rate previously approved would result in a situation where the non-Medicare patients would get the benefit of expenditures made solely for the benefit of Medicare patients. Under such circumstances, the retroactive recapture of excess accelerated depreciation allowances is not such an unreasonable or oppressive application of the regulation as to constitute a denial of due process.

Constitutional Law ⚖318(2)

Contracts; authority of Government agent; unauthorized act of agent; Government not bound by.

[9] The unauthorized acts of Medicare fiscal intermediaries are not binding on the agency Secretary.

Social Security and Public Welfare ⚖241.10

Constitutional law; equal protection of the law; Medicare Act; retroactive corrective adjustments.

[10] Since 42 U.S.C. § 1395x(v)(1) requires the Secretary to make retroactive corrective adjustments, the fact that some fiscal intermediaries may have failed to apply 20 C.F.R. § 405.415(d)(3) retroactively to other providers whereas plaintiff was not accorded this treatment, was not an unlawful discrimination violative of plaintiff's constitutional right to equal protection of the law.

Constitutional Law ⚖242.3(1)

Thomas C. Fox for plaintiff. *William A. Geoghegan*, attorney of record. *George R. Clark* and *Pierson, Ball & Dowd*, of counsel.

Jean Schepers, with whom was *Assistant Attorney General Barbara Allen Babcock. Julie P. Dubick* and *David R. Schlee* of counsel.

Before COWEN, *Senior Judge,* DAVIS and KUNZIG, *Judges.*

COWEN, *Senior Judge,* delivered the opinion of the court:

Plaintiff, a Maryland corporation, is a provider of skilled nursing care to persons eligible for those services under the Social Security Act, 42 U.S.C. §§ 1395, *et seq.*, commonly referred to as the Medicare program. Plaintiff brought this action to recover the sum of $47,189. This amount had been allowed for accelerated depreciation and paid as a reasonable cost reimbursement owed plaintiff for services as a provider of skilled nursing care under the Medicare program, but the $47,189 was subsequently recaptured by the defendant through its agent, Mutual of Omaha, pursuant to 20 C.F.R. § 405.415(d)(3), issued by the Social Security Administration, Department of Health, Education, and Welfare (HEW).

The case was first argued before the court on defendant's motion to dismiss and plaintiff's opposition thereto. At that time, the court was informed that a proposed regulation concerning the extent and incidence of retroactivity under 42 U.S.C. § 1395x(v) (Supp. V 1975) had been published in June 1975 (40 Fed. Reg.26535), but we did not know whether that or any other pertinent regulation had been adopted, or what the position of HEW was on the proposed regulation. Accordingly, by order of October 21, 1976, 211 Ct. Cl. 346, we remanded the case to HEW for a renewed determination of plaintiff's claim, in accordance with the present policy and position of HEW. Thereafter, the defendant filed its response to the court's order, and by means of a letter and affidavit attached, advised the court that the proposed regulation had not been adopted and that no new regulation or instruction had been promulgated or issued by the Secretary of HEW (hereinafter Secretary) which would affect the recapture of accelerated depreciation from a provider because of a decline in the utilization of its facilities by Medicare patients. Following

the responses to the court's orders, plaintiff filed its motion for summary judgment and defendant its cross-motion for summary judgment.

After again hearing oral argument and considering the pleadings, motions, and briefs of the parties we have, for the reasons to be set forth, concluded that plaintiff is not entitled to recover and that its petition should be dismissed.

I.

Under the "Medicare" provisions of the Social Security Act, a provider, such as plaintiff, is not paid for its services by the patients. Instead, the provider is reimbursed by the Secretary from the Federal Hospital Insurance Trust Fund, which is financed by special wage taxes. 42 U.S.C. § 1395i. Pursuant to 42 U.S.C. § 1395g, a provider receives interim pre-audit reimbursements not less than monthly based on billings submitted to the Secretary or his designate. At the close of the fiscal year, the provider submits a cost report and the Secretary then determines by audit the actual amount of reimbursement which the provider is entitled to for that year. 20 C.F.R. § 405.451(b)(1). Adjustments are thereafter made in the current interim payments in accordance with the amount determined to be due the provider as shown by the audit. The Medicare program is administered in substantial part by private organizations under contract with the Secretary. 42 U.S.C. § 1395h authorizes a provider to nominate a private organization to act as fiscal intermediary. Plaintiff became a provider of services under the program on January 1, 1967 and nominated Mutual of Omaha. Mutual of Omaha then entered into an agreement with the Secretary to act as fiscal intermediary for plaintiff. The provider submits its bills for all services to the intermediary, who is responsible for their payment as agent for the Secretary. Section 1395f(b) (Supp. V, 1975) provides that the total amount to be paid to a provider shall be "the reasonable cost" of services rendered to Medicare beneficiaries as determined under section 1395x(v). The latter section states that reasonable costs shall be determined in regulations issued

by the Secretary establishing the methods of cost calculation. Section 1395x(v)(1)(A)(i) further provides that the regulations must take into account direct and indirect costs of providers so that costs for individuals covered by the insurance program will not be borne by individuals not covered, and that costs with respect to individuals not covered will not be borne by the insurance program. Section 1395x(v)(1)(A)(ii) also requires that the regulations must provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive."

From 1966 until August 1, 1970, the regulations permitted an allowance for accelerated depreciation on capital assets as a reimbursable cost. 20 C.F.R. § 405.415 (1967). Plaintiff exercised its option to claim an allowance for accelerated depreciation as an item of reimbursable cost and its claims on that basis were approved for the fiscal years ending October 31, 1967 through October 31, 1971.

Beginning in 1969, HEW issued new and more restrictive guidelines to intermediaries for determining the eligibility of persons for Medicare benefits in skilled nursing facilities. As a result, there was a substantial decline in Medicare utilization of plaintiff's facility.[1]

On February 5, 1970, the Secretary published a proposed regulation regarding depreciation, 35 Fed. Reg. 2593. It was announced that the following changes would be made in the treatment of accelerated depreciation: (a) nursing homes certified after August 1, 1970 could not use that method of calculating depreciated costs; (b) providers then participating in the program could not use the accelerated method for newly acquired assets; (c) on capital assets for which the accelerated method of depreciation had been used prior to August 1, 1970, that method could continue to be used; and of particular pertinence to this litigation (d) if

[1] Although defendant has not admitted that the decline in the use of plaintiff's facility by Medicare patients was due to the restricted eligibility requirements, there is some evidence to indicate that plaintiff's assertion on this point is correct and for the purposes of this motion, we have accepted it as true.

a provider terminated its participation in the program, or if the Medicare proportion of its allowable costs decreased substantially, the Secretary could recover "the excess of reimbursable costs determined by using accelerated depreciation methods when these costs had been paid over the reimbursable costs which would have been determined and paid by using the straight-line method of depreciation." On August 1, 1970, the new regulation promulgated by the Secretary, 20 C.F.R. § 405.415(d)(3), became effective. It provided as follows in relevant part:

> When a provider who has used an accelerated method of depreciation with respect to any of its assets terminates participation in the program, or where the health insurance proportion of its allowable costs decreases so that cumulatively substantially more depreciation was paid than would have been paid using the straight-line method of depreciation, the excess of reimbursable cost, determined by using accelerated depreciation methods and paid under the program over the reimbursable cost which would have been determined and paid under the program by using the straight-line method of depreciation will be recovered as an offset to current reimbursement due or, if the provider has terminated participation in the program, as an overpayment. In this determination of excess payment, recognition will be given to the effects the adjustment to straight-line depreciation would have on the return on equity capital and on the allowance in lieu of specific recognition of other costs in the respective years.

The regulation of August 1, 1970 did not state expressly that it would be applied retroactively to the fiscal years audited prior to the issuance of the regulation. However, in May 1972, the Bureau of Health Insurance issued a proposed revision to the Providers Reimbursement Manual which was referred to as a manualization of the regulation of August 1, 1970. The manual provided for the retroactive recovery of the amount by which accelerated depreciation costs exceeded costs permitted under the straight-line method of depreciation for all providers who terminated their participation in the program after July 1, 1970. However, providers who had previously taken accelerated depreciation allowances and terminated their participation prior to August 1, 1970, would not be subjected to recovery.

Providers who remained in the program after the effective date of the regulation would, if they terminated participation in the program or if there was a substantial decline in Medicare utilization of their facilities, be subject to a recovery of accelerated depreciation costs retrospectively to the date of their entry in the program. In plaintiff's case, this was January 1967. The manual revision was issued as section 136 of HIM–15 (Providers Reimbursement Manual). On May 25, 1972, Mutual of Omaha notified plaintiff that pursuant to the manualization of the regulation, it was recapturing $44,000 in costs previously determined to be due plaintiff as reimbursement for accelerated depreciation in excess of the amounts that would have been allowed for straight-line depreciation for the fiscal years ending October 31, 1967 through October 31, 1971. Subsequently in January 1974, Mutual of Omaha revised the amount of the excess depreciation allowance to be recovered from plaintiff to a total of $47,189, for which plaintiff now seeks recovery. The amount claimed was recovered from plaintiff by withholding Medicare reimbursement payments due plaintiff.

II.

Plaintiff's contentions require us to decide the following issues:

1. Whether the retroactive application of the regulation (20 C.F.R. § 405.415(d)(3) is authorized by the Medicare Act and the Administrative Procedure Act.

2. Whether the retroactive application of the regulation which resulted in the recapture of accelerated depreciation costs allowed prior to August 1, 1970, contravened the due process clause of the Fifth Amendment.

3. Assuming arguendo that the changes made by the Secretary in eligibility requirements in 1969 caused a decrease in plaintiff's participation in the Medicare program, was the Secretary's action in recouping funds from the plaintiff an unlawful and invalid act?

4. Assuming arguendo that some fiscal intermediaries refused to enforce the regulation retroactively against other providers in the same position as plaintiff, was the

application of the regulation to plaintiff a denial of equal protection of the law?

Several recent appellate decisions have upheld both the constitutional and statutory validity of the regulation. *Springdale Convalescent Center v. Mathews*, 545 F.2d 943 (5th Cir. 1977); *Adams Nursing Home, Inc. v. Mathews* 548 F.2d 1077 (1st Cir. 1977); *Hazelwood Chronic & Convalescent Hosp., Inc. v. Weinberger*, 543 F.2d 703 (9th Cir. 1976) *vacated and remanded on other grounds*, 430 U.S. 952, (1977).

Plaintiff relies on the following district court decisions: *Hazelwood Chronic & Convalescent Hospital, Inc. v. Weinberger*, C.A. No. 73–210 (D. Ore. 1974), *rev'd* 543 F.2d 703 (1976); *South Windsor Convalescent Home, Inc. v. Weinberger*, 403 F. Supp. 515 (D. Conn. 1975) *rev'd for lack of jurisdiction*, 541 F.2d 910 (2d Cir. 1976); *Columbia Heights Nursing Home, Inc. v. Weinberger*, 380 F. Supp. 1066 (M.D. La. 1974); *Mt. Sinai Hospital of Greater Miami, Inc. v. Weinberger*, 376 F. Supp. 1099 (S.D. Fla. 1974, *rev'd* 517 F.2d 329 (5th Cir. 1975), and *Fairfax Nursing Center, Inc. v. Califano*, C.A. No. 77–83–A (E.D. Va. June 2, 1977), *appeal filed* 4th Cir. July 22, 1977.

After a review of the two lines of decisions, we find that we are in agreement with the opinions of the First, Fifth and Ninths Circuits, and follow them as a basis for deciding the issues in this case.

III.

Plaintiff has challenged the statutory validity of the regulation (20 C.F.R. § 405.415(d)(3)) on several grounds.

Plaintiff first argues that the "retroactive corrective adjustment" required by section 1395x(v)(1)(A)(ii) is limited to a single prior fiscal period in order that the interim monthly payments to a provider may be brought into agreement with the amounts found payable by the audit for the fiscal year in question. This contention was flatly rejected by the Second Circuit in *Kingsbrook Jewish Medical Center v. Richardson*, 486 F.2d 663, 669–70 (2d Cir. 1973); by this court in *Whitecliff, Inc. v. United States*, 210 Ct.Cl. 53, 60 & n. 11, 536 F.2d 347, 352 & n. 11 (1976), *cert.*

denied, 430 U.S. 969 (1977), and by the Fifth circuit in *Springdale Convalescent Center v. Mathews, supra*, at 954. In *Kingsbrook*, the court explained that the requirement that the interim payments be reconciled with the final audit figure, is set forth in a separate section (section 1395g) which covers adjustments resulting from " 'previously made overpayments or underpayments * * *.' " The court further declared that section 1395x(v)(1) deals with the corrective adjustments that are "designed to rectify mistakes made by HEW in formulating a particular method of determining cost," and that the retroactive corrective adjustments required by that section are not limited to a single prior fiscal period. Moreover, the validity of the regulation has been upheld by the appellate courts on the ground that it is mandated by section 1395x(v)(1)(A)(ii); is "reasonably related to the purposes of the enabling legislation," and represents a determination by the Secretary resulting from "the exercise of his economic judgment in an area committed to his expertise." *Springdale Convalescent Center v. Mathews, supra*, at 951, 955.

Plaintiff's next contention is that the regulation and the retroactive adjustment made thereunder were not authorized by statute, because the Secretary failed to make a formal finding that the prior method of reimbursing providers was inadequate or excessive. There is nothing in the governing statute which requires such a finding, but plaintiff argues that we held in *Whitecliff, supra*, that before the retroactive adjustment could be made, the Secretary had to make the finding. Plaintiff has misinterpreted our holding in *Whitecliff*. There the plaintiff provider challenged the rejection of an attempt to use its work measurement study to prove that the current cost method was inadequate. We decided that the government's attempt to correct the situation by a prospective regulation, which permitted a change in method, did not comply with the statutory requirement for a regulation that would make "suitable retroactive corrective adjustments." We relied on the Second Circuit's decision in *Kingsbrook* and stated that section 1395x(v)(1)(A)(ii) authorized the retroactive adjustments for any prior period where the current

method of adjustment had proven to be inadequate or excessive. We did not require a formal finding by the Secretary of an inadequate or excessive method.

Further responsive to this contention of plaintiff is the implied conclusion of the First Circuit in *Adams Nursing Home, supra,* at 1082, that the regulation itself is a determination that "accelerated depreciation exaggerates the true cost of providing services." The Fifth Circuit reached the same conclusion in *Springdale Convalescent Center, supra.* We agree.

In its third challenge to the validity of the regulation, plaintiff contends that the Administrative Procedure Act, 5 U.S.C. § 551(4) limits the Secretary's rule-making authority to the promulgation of regulations of prospective application. Plaintiff emphasizes the word "future" in section 551(4).[2] The rule regarding the validity of retroactive regulations was stated by the Supreme Court in *Securities and Exchange Comm'n v. Chenery Corp.,* 332 U.S. 194, 203 (1947) as follows:

> Hence we refuse to say that the Commission, which had not previously been confronted with the problem of management trading during reorganization, was forbidden from utilizing this particular proceeding for announcing and applying a new standard of conduct. Cf. *Federal Trade Commission v. Keppel & Bro.,* 291 U.S. 304. *That such action might have a retroactive effect was not necessarily fatal to its validity.* Every case of first impression has a retroactive effect, whether the new principle is announced by a court or by an administrative agency. But such retroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal and equitable principles. *If that mischief is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law. See*

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[2] Section 551(4) provides:

"(4) 'rule' means the whole or a part of an agency statement of general or particular applicability and *future* effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency and includes the approval or prescription for the *future* of rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services or allowances therefor or of valuations, costs, or accounting, or practices bearing on any of the foregoing;" (emphasis added.)

Addison v. Holly Hill Co., 322 U.S. 607, 620. (emphasis added).

As we have previously emphasized, the regulation issued here was mandated by statute so that it can hardly be said that it was contrary to the "statutory design." It is well settled, that administrative agencies are required to follow a congressional mandate. *United Steelworkers of America, AFL-CIO v. N.L.R.B.*, 390 F.2d 846 (D.C. Cir. 1967), *cert. denied*, 391 U.S. 904 (1968). We therefore conclude that the recapture regulation in issue in this case was not prohibited by 5 U.S.C. 551(4). *Adams Nursing Home, Inc. v. Mathews, supra*, at 1080 n. 8.

IV.

Relying heavily on the district court decisions cited above, plaintiff's main contention in this case is that the recapture provisions of the regulation before us violate the Fifth Amendment guarantee of due process. In the cases cited above, the First, Fifth, and Ninth Circuits have considered the constitutional issue so thoroughly that we need only summarize respectively their conclusions that the retroactive application of the recapture provisions of the regulation did not constitute a denial of due process:

1. In passing on the validity of a retroactive ruling, courts generally compare the public interest in the retroactive rule with the "private interests that are overturned by it." When the providers entered into this program, they must have been aware that they were joining a new government program which would be subject to future regulation by the Secretary. *Adams Nursing Home, Inc. v. Mathews, supra*, at 1080–81.

2. The Secretary had a right to issue the regulation in order to cure the defect arising from prior mistakes in the administration of the program, and the retroactive application of the recapture proceedings was required by act of Congress to insure that the reimbursement provided by the government will go to pay only for the costs of services to Medicare beneficiaries. *Springdale Convalescent Center v. Mathews, supra*, at 956.

3. The retroactive effects of the regulation were limited and reasonable; it was not made effective until nearly 6 months after notice of its promulgation was given; it is particularly reasonable "since it is part of the ongoing adjustment necessary in a program of distributing federal subsidies." *Hazelwood Chronic & Convalescent Hosp., Inc. v. Weinberger, supra,* at 708.

V.

In urging us not to follow the above-cited appellate decisions, plaintiff points to a factual distinction in this case. In each of those cases, the provider voluntarily terminated its participation in the program after August 1, 1970. In each, the courts observed that the provider might have avoided the recapture of payments previously received by terminating participation in the program before August 1, 1970, and that termination thereafter would result either in a windfall to the provider or a decrease in the cost of caring for non-Medicare patients at the expense of Medicare patients. There was a substantial decline in the number of Medicare patients served by plaintiff from the latter part of 1969 until the end of 1972. Plaintiff alleges and we have assumed that this substantial reduction occurred because HEW issued new and more restrictive guidelines to intermediaries for determining the eligibility for Medicare benefits in nursing homes. In support of its argument that these facts distinguish this case from the circuit cases cited, plaintiff cites a decision of June 8, 1977 by the Provider Reimbursement Review Board.[3] In that case, the Board found that the change in the provider's Medicare utilization was not the result of any admission policy of the provider, but was substantially "related to a change in eligibility requirements for Medicare benefits * * *." The Board concluded that the intermediary's recapture of depreciation in excess of straight-line depreciation was proper for periods ending after December 31, 1969, but was improper for periods ending on or before December 31, 1969, because such a result would penalize the provider for its decrease in

[3] (1977), MEDICARE & MEDICAID GUIDE (CCH) para. 28,519, at 9845.

Medicare utilization just the same as if the decrease had been voluntary. The Board concluded that this would be contrary to the principles of reasonableness and equitable treatment. Plaintiff makes this same argument.

We find this to be the most appealing argument which has been advanced in plaintiff's behalf. Consequently it becomes necessary to consider whether, under all the circumstances, the "retroactive application [of the regulation] is so harsh and oppressive as to transgress the constitutional limitation [imposed by the Fifth Amendment]." *Welch v. Henry*, 305 U.S. 134, 147 (1938). Retroactive application of a regulation will not be declared unconstitutional unless after a balancing of the considerations on both sides it is determined that the regulation is unreasonable. Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 HARV. L. REV. 692, 694 (1960). The same commentator has observed that the Supreme Court has frequently sustained the retroactive operation of statutes where contracts are made or property rights are acquired in an area that is subject to regulation, *id.* at 700. The strong public interest in the smooth functioning of government has resulted in favorable treatment of curative statutes. The "interest in the retroactive curing of such a defect in the administration of government outweighs the individual's interest in benefiting from the defect," *id.* at 705–06.

After weighing and considering all of the factors involved, we do not find that the retroactive application of the regulation in plaintiff's case violated its constitutional rights. It may very well be true that the recapture of money paid plaintiff frustrated the financial plans which plaintiff had made for capitalizing the cost of assets it had constructed to provide services to both Medicare and non-Medicare patients. Nevertheless, the Secretary determined, in the regulation, that when a substantial decrease in the utilization of plaintiff's facilities by Medicare patients occurred, a continued allowance of accelerated depreciation at the rate previously approved would result in a situation where the non-Medicare patients would get the benefit of expenditures made solely for the benefit of Medicare patients. In view of the explicit statutory obligation

imposed on the Secretary, we cannot say that the retroactive recapture here was such an unreasonable or oppressive application of the regulation that it constituted a denial of due process.

Plaintiff also argues that it could not have terminated its participation in the Medicare program when it was notified of the proposed amendment to the existing regulation in February 1970, because of the provisions of 20 C.F.R. § 405.613 (33 Fed. Reg. 11274, August 8, 1968). Section (a) of this regulation stated that if a provider gave notice to terminate, the Secretary had a right to accept the termination date specified or to set a different date, and that if the notice did not specify a date, the Secretary would set a date which was not more than 6 months from the date of the receipt of the notice. Therefore, plaintiff says that it could not have left the program until October 31, 1970 at the earliest. However, section (b) of the same regulation provided that the Secretary could permit termination by providers less than 6 months before the termination date stated in their notices, if the Secretary determined that to do so would not unduly disrupt the furnishing of services to the community by the provider, or otherwise interfere with the effective and efficient administration of the health benefits program provided by the Act.

Plaintiff does not claim that it made any request to terminate its participation in the program prior to August 1, 1970, or that such a request was denied by the Secretary. Therefore, we are not faced with the difficult problem that would have been presented if those events had occurred.

VI.

Plaintiff's final contention is that some fiscal intermediaries, even as late as 1974, refused to enforce the regulation retroactively against providers who were in the same position as plaintiff, and that this discriminatory action denied plaintiff "equal protection of the law." To the extent that this unequal treatment occurred, the unauthorized acts of the intermediaries were not binding on the Secretary. *Utah Power & Light Co. v. United States*, 243 U.S. 389 (1917); *Bornstein v. United States*, 170 Ct. Cl. 576,

345 F.2d 558 (1965). Since the statute required the Secretary to make the retroactive corrective adjustments, the fact that some intermediaries may have failed to apply the regulation retroactively to other providers, was not an unlawful discrimination which violated plaintiff's constitutional rights. The situation is analogous to retroactive rulings made by the Commissioner of Internal Revenue to correct a mistake of law in the collection of income taxes. It has been repeatedly held that taxpayers are not entitled to relief against such retroactive rulings despite the fact that other taxpayers had received favorable treatment under prior rulings. *Automobile Club of Michigan v. Commissioner*, 353 U.S. 180, *reh. denied*, 353 U.S. 989 (1957); *Weller v. Commissioner*, 270 F.2d 294 (3d Cir. 1959), *cert. denied*, 364 U.S. 908 (1960); *Bornstein v. United States*, *supra*. We think the same principles are applicable here.

VII.

It follows from the foregoing opinion that plaintiff's motion for summary judgment is denied; defendant's cross-motion for summary judgment is granted, and plaintiff's petition is dismissed. In view of this disposition of the case, plaintiff's request that its petition be treated as a class action is also denied.

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571 F.2d 552

APARACOR, INC., FORMERLY QUEEN'S-WAY TO FASHION, INC. v. THE UNITED STATES

[No. 139–73. Decided February 22, 1978]

ON PLAINTIFF'S MOTION FOR COSTS INCLUDING ATTORNEYS' FEES

Taxes; suits for refund of taxes; attorneys' fees; Civil Rights Attorney's Fees Awards Act of 1976.—Plaintiff seeks an award of costs including attorneys' fees pursuant to 42 U.S.C. § 1988, *as amended* by Pub. L. 94–559, incurred in this withholding tax case in which the court held that plaintiff was entitled to a refund of the federal unemployment taxes paid for 1970, plus assessed interest. Plaintiff

Syllabus

contends that defendant acted in bad faith. It is *held* that the language and the legislative history of Pub. L. 94–559 compel the conclusion that this court is not authorized to award attorneys' fees in this type of tax refund suit. Plaintiff's motion is denied.

Claims against the United States; tax refund suit; recovery of attorneys' fees.

[1] This court does not have the power to award attorneys' fees without specific authorization by act of Congress. 28 U.S.C. § 2412.

United States ⚖147

Taxes; civil action or suit for refund of taxes; recovery of attorneys' fees; Civil Rights Attorney's Fees Awards Act of 1976.

[2] As confirmed by the legislative history of the Civil Rights Attorney's Fees Awards Act of 1976, the plain meaning of the Act with respect to tax suits is that it is intended to apply solely to prevailing defendants where the Internal Revenue Service or the United States brings an action against a taxpayer to enforce a provision of the Code; it does not apply to actions instituted against the Government by the taxpayer.

Internal Revenue ⚖2208

Statutes; construction and operation; legislative intent; subsequent Congress, opinion expressed by.

[3] The views of members of subsequent legislatures as to the intent of a prior Congress in passing a statute are entitled to little weight.

Statutes ⚖216

Statutes; construction and operation; context and related clauses.

[4] It is a fundamental maxim that a statute should, if possible, be construed so as to give effect to all parts of the statute rather than render some of the language superfluous or nugatory.

Statutes ⚖216

Taxes; statutes; construction and operation; legislative intent; Civil Rights Attorney's Fees Awards Act of 1976.

[5] The chief concern of Congress in enacting Pub. L. 94–559 was to return to the courts the ability to award attorneys' fees to prevailing parties in a suit brought by or on behalf of the United States and to undo in part the effect of the decision of the Supreme Court in *Alyeska Pipeline Service Co.* v. *Wilderness Soc.*, 421 U.S. 240 (1975).

Civil Rights ⚖46

Taxes; statutes; construction and operation; Civil Rights Attorney's Fees Awards Act of 1976; "proceeding".

[6] There is nothing in the legislative history of S. 2278 before enactment as Pub. L. 94–559 to indicate a broader meaning for the word "proceeding" than an actual suit before a court. The statute contemplates the award of attorneys' fees only in connection with litigation before a court.

Civil Rights ⚖46

Claims against the United States; recovery of costs.

[7] It is the customary practice of this court to deny costs to either of the litigating parties.

United States ⚖147

Warren C. Seieroe, attorney of record, for plaintiff. *Lawrence Gerber, Michael R. Fayhee, Judith S. Horn* and *McDermott, Will & Emery*, of counsel.

Assistant Attorney General M. Carr Ferguson for defendant. *Robert S. Watkins*, of counsel.

Before COWEN, *Senior Judge*, DAVIS, NICHOLS, KASHIWA, KUNZIG, and BENNETT, *Judges, en banc*.

DAVIS, *Judge*, delivered the opinion of the court:

We have heard this case *en banc* because it is the first to present the general issue of whether the Civil Rights Attorney's Fees Awards Act of 1976, Pub. L. No. 94–559, 90 Stat. 2641, applies to tax refund suits in this court. The question is raised by the plaintiff's motion for the award of costs including attorneys' fees pursuant to 42 U.S.C. § 1988 (1970), *as amended by* The Civil Rights Attorney's Fees Awards Act of 1976, *supra*.[1] The costs were incurred in a withholding tax case before the court in which the issue was whether numerous individuals and groups or organizations of individuals engaged in selling the plaintiff's products at retail on a commission basis were independent contractors or employees of the plaintiff. The Internal Revenue Service had determined that taxes under the Federal Insurance Contributions Act and the Federal Unemployment Tax Act were owed by the plaintiff for the years 1968, 1969, and 1970 and had assessed the Federal Unemployment tax with interest for the year 1970. The

[1] The plaintiff submitted the following bill of costs with its motion:

Filing fee	$ 10.00
Printing petition and brief	1,024.00
Reporters and transcripts	1,495.00
Attorney fees	164,548.00
Reimbursement of attorney expenses	6,212.00
Total	$173,289.00

plaintiff paid its Federal Unemployment tax for that year (with the assessed interest) and brought suit for a refund. A trial was held, and the plaintiff prevailed on the merits. *Aparacor, Inc. v. United States*, 214 Ct. Cl. 130, 556 F.2d 1004 (1977). It now seeks the award of court costs including attorneys' fees on the ground that the defendant acted in bad faith, that the position taken by the Government was so utterly contrary to case law, revenue rulings, and prior practice that "it is apparent that without regard to right or wrong, the IRS sought by administrative action to bludgeon plaintiff into doing its bidding or risk financial ruin."

Wholly aside from the claimed bad faith of the Government, we hold that The Civil Rights Attorney's Fees Awards Act of 1976 does not authorize us to award attorneys' fees in this type of tax refund suit.[2] Both the language[3] and the legislative history compel this result. The statute states that "in any civil action or proceeding,

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[2] It is common ground that this court does not have the power to award attorneys' fees without specific authorization by act of Congress. 28 U.S.C. § 2412 (1970); *Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 266–68 (1975); *Yee v. United States*, 206 Ct. Cl. 388, 394 n.6, 512 F.2d 1383, 1385 n.6 (1975); *Middleton v. United States*, 175 Ct. Cl. 786, 795–96 (1966).

[3] 42 U.S.C. § 1988 (1970), *as amended by* The Civil Rights Attorney's Fees Awards Act of 1976, Pub. L. No. 94–559, 90 Stat. 2641, provides as follows:

Sec. 1988. Proceedings in vindication of civil rights.

The jurisdiction in civil and criminal matters conferred on the district courts by the provisions of this chapter and Title 18, for the protection of all persons in the United States in their civil rights, and for their vindication, shall be exercised and enforced in conformity with the laws of the United States, so far as such laws are suitable to carry the same into effect; but in all cases where they are not adapted to the object, or are deficient in the provisions necessary to furnish suitable remedies and punish offenses against law, the common law, as modified and changed by the constitution and statutes of the State wherein the court having jurisdiction of such civil or criminal cause is held, so far as the same is not inconsistent with the Constitution and laws of the United States, shall be extended to and govern the said courts in the trial and disposition of the cause, and, if it is of a criminal nature, in the infliction of punishment on the party found guilty. [In any action or proceeding to enforce a provision of sections 1977, 1978, 1979, 1980, and 1981 of the Revised Statutes, title IX of Public Law 92–318, *or in any civil action or proceeding, by or on behalf of the United States of America, to enforce, or charging a violation of, a provision of the United States Internal Revenue Code*, or title VI of the Civil Rights Act of 1964, the court, in its discretion, may allow the prevailing party, other than the United States, a reasonable attorney's fee as part of the costs.]

The portion in brackets was added to 42 U.S.C. § 1988 (1970) by Pub. L. No. 94–559, while the italicized portion was added to Pub. L. No. 94–559 during the Senate floor debate by an amendment of Senator Allen.

by or on behalf of the United States of America, to enforce, or charging a violation of, a provision of the . . . Internal Revenue Code, . . . the court, in its discretion, may allow the prevailing party, other than the United States, a reasonable attorney's fee as part of the costs." The defendant says that the statute is not applicable here because the suit was initiated by the taxpayer, rather than brought "by or on behalf of the United States." That seems to be the meaning of the words on their face. The Act governs suits in which the Government is the initiator and actor, but in an ordinary refund action such as this the taxpayer, not the Government, is the initiator and the actor. The "civil action or proceeding" is not "by or on behalf of the United States of America" but rather "by or on behalf of" the taxpayer. This normal understanding of the bare language is not conclusive but it is entitled to prevail unless overcome by a persuasive showing from the purpose or history of the legislation. *Prairie Band of the Pottawatomie Tribe of Indians v. United States, ante* at 15, 564 F.2d at 46.

Far from being subverted by the legislative history of the Civil Rights Attorneys' Fees Awards Act, the "plain meaning" of that Act (with respect to tax suits) is fully confirmed by its history and background. The Senate bill, S. 2278, originally contained no references to actions or proceedings under the Internal Revenue Code. The House and Senate reports[4] connected with the civil rights attorneys' fees legislation likewise made no reference to tax suits, or to the language in issue, which was added to S. 2278 as an amendment by Senator Allen, who made the following comments on his amendment when it was called upon the Senate floor on September 29, 1976:[5]

> What [the amendment] does is to add to the civil rights attorneys' fees provision a provision that *if the Internal*

[4] S. Rep. No. 94–1011, 94th Cong., 2d Sess., *reprinted in* [1976] U.S. Code Cong. & Ad. News 5908, which accompanied S. 2278, was concerned solely with attorneys' fees in connection with civil rights litigation, as was H.R. Rep. No. 94–1558, 94th Cong., 2d Sess. (1976), which accompanied H.R. 15460. The two bills, as reported out by the Senate and House of Representatives Judiciary Committees were identical, except that H.R. 15460 was also applicable to title IX of Pub. L. No. 92–318, not covered by the Senate bill.

[5] 122 Cong. Rec. S17049 (daily ed. Sept. 29, 1976).

Revenue Service or the U.S. Government brings a civil action against a taxpayer to enforce any provision of the Internal Revenue Code, and the Government does not prevail against the taxpayer, then the court, in its discretion, just as in the other cases, would be entitled to award the taxpayer reasonable attorneys' fees. That is all it does, and I hope the amendment will be agreed to [emphasis added].

Senator Tunney also made clear the limited applicability of the amendment in his remarks after Senator Allen's introduction of the amendment:[6]

> Mr. President, as initial sponsor of S. 2278, I would like to make clear my understanding of the intent of this amendment, which I support.
>
> Essentially, it would apply to a situation where a taxpayer is harrassed [*sic*] by the IRS. In such a case, *a court has discretion to award reasonable attorneys' fees to the defendant.* The standard to be applied is the one the courts have adopted with respect to prevailing defendants, as described in the Senate report.
>
> The purpose of this amendment is not to discourage meritorious lawsuits by the IRS, but to discourage frivolous or harrassing [*sic*] lawsuits.
>
> *The amendment would not apply to a situation where the Government is plaintiff on appeal since the Government did not bring the action in the first instance* [emphasis added].

After adoption of the amendment, but before passage of the bill by the Senate, Senator Kennedy explained the applicability of the amendment:[7]

> As I understand the provisions of the Allen amendment, *a court would be authorized to award attorneys' fees to a taxpayer who is a defendant in a civil action brought by the U.S. Government to enforce the provisions of the Internal Revenue Code.* The usual standard applied in cases where fees are awarded to prevailing defendants would apply here as well—that is, *awards are appropriate where the action initiated by the plaintiff, the Government,* acted in a frivolous or vexatious manner or brought the suit for purposes of harassment. . . . .
>
> Since *the amendment is intended to apply solely to prevailing defendants in tax cases,* the courts would be

[6] 122 Cong. Rec. S17050 (daily ed. Sept. 29, 1976).

[7] 122 Cong. Rec. S17050-51 (daily ed. Sept. 29, 1976).

guided by well-settled judicial standards in the exercise of their discretionary authority to make fee awards to defendants. These standards are discussed in the Senate report on S. 2278. They are discussed with greater detail in the House report on its companion bill. In general, the taxpayer would have to show bad faith on the part of the Government in bringing suit against him in order for fees to be allowed.

The courts have articulated the policy reasons for utilizing a stricter test in awarding fees to prevailing defendants than to prevailing plaintiffs, and these apply equally in tax cases and in actions brought to enforce the civil rights laws. Awarding fees to prevailing defendants is intended to protect parties from being harassed by unjustifiable lawsuits. *It is not,* however, *intended* to deter plaintiffs from seeking to enforce the protections afforded by our civil rights laws, or in this instance *to deter the Government from instituting legitimate tax cases* by threatening it with the prospect of having to pay the defendant's counsel fees should it lose. Were Congress or the courts to provide otherwise, it would have a substantial chilling effect on the bringing of genuinely meritorious actions. I am sure that *none of us would want to inhibit responsible lawsuits brought by the United States to enforce the tax laws of our country.*

It should be clear, then, that a provision authorizing fee awards in tax cases has a fundamentally different purpose from one authorizing awards in lawsuits brought by private citizens to enforce the protections of our civil rights laws. In enacting the basic civil rights attorneys [*sic*] fees awards bill, Congress clearly intends to facilitate and to encourage the bringing of actions to enforce the protections of the civil rights laws. *By authorizing awards of fees to prevailing defendants in cases brought under the Internal Revenue Code, however, Congress merely intends to protect citizens from becoming victims of frivilous* [*sic*] *or otherwise unwarranted lawsuits.* Enactment of this amendment should in no way be understood as implying that Congress intends to discourage the Government from initiating legitimate lawsuits under the tax laws [emphasis added].

After passage by the Senate of S. 2278 with the Allen amendment, the House on October 1, 1976 then proceeded to consider the bill. Representative Drinan, who acted as sponsor of S. 2278 in the House, was quite explicit in his

view that the bill would not apply to a situation such as is before the court in the present case:[8]

> The Allen amendment would allow the prevailing party to recover its counsel fees in any civil action brought by the United States to enforce the Internal Revenue Code. *It would not apply to actions instituted against the Government by the taxpayer.* Since S. 2278 does not allow the U.S. Government to recover its fees under any circumstances, the effect of the Allen amendment is to permit prevailing defendants in such cases to recover their attorney fees if they satisfy the criteria generally applicable under the bill to prevailing defendants, which I will discuss later at greater length.
>
> Briefly, under settled judicial standards, prevailing defendants would recover their attorney fees only if they could prove that the United States brought the action to harass them, or if the suit is frivolous and vexatious [emphasis added].

In reaching our decision, we are not unmindful of the remarks made by Senator Allen on the floor of the Senate on January 14, 1977:[9]

> I inserted the word "proceeding" in my new amendment specifically to include administrative proceedings or audits so that fees and costs in connection with audits or other IRS agency proceedings could be awarded by a court on application of a prevailing taxpayer. I also included the term "proceeding" so that it would be clear that in any case involving a disputed tax, the court would be free to award attorney fees so long as the taxpayer prevailed and the court felt that a fee award was appropriate considering all factors in the case and notwithstanding the formalistic characterization of the taxpayer as plaintiff or defendant or as appellant and appellee.
>
> Incredibly, Mr. President, some commentators have suggested that my amendment would only apply in cases in which the Internal Revenue Service brought an action to recover an alleged overpayment of a tax refund. I find that suggestion ludicrous. Certainly that could not have

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[8] 122 Cong. Rec. H12159 (daily ed. Oct. 1, 1976).

Similar remarks to the effect that attorneys' fees would be allowed to prevailing defendants in tax cases brought by the United States were made by Representatives Kastenmeier and Seiberling before the House adopted S. 2278 on October 1, 1976. 122 Cong. Rec. H12162, H12166 (daily ed. Oct. 1, 1976).

[9] 123 Cong. Rec. S732 (daily ed. Jan. 14, 1977).

> been in the mind of any Senator here when we adopted my proposal. No, Mr. President, that interpretation of my amendment would make our action meaningless and would require a highly formalistic—indeed, almost 18th century—reading of the words used. Mr. President, the idea is simple, and I believe it was reasonably clearly expressed.
>
> The idea simply is that in any proceeding in which the Government asserts a taxpayer's liability for a tax and the taxpayer asserts that he is not liable for the tax and thereafter prevails, then a court may award fees to the taxpayer as the court sees fit. The form which the action takes is not of consequence. Since all tax disputes boil down to the Government asserting a liability and a taxpayer denying it, the formal position of the two parties is immaterial. The problem my amendment corrects does not relate to procedural formalities; it relates instead to the substantive imbalance in resources available to the Government and to a taxpayer when the two dispute an issue of tax liability. Thus, differing standards with respect to a plaintiff or a defendant, which a court might for policy reasons apply in litigated controversies in other areas of the law, have no proper application in tax disputes.
>
> There is only one kind of tax dispute regardless of who is a named plaintiff or a named defendant, or who is an appellant or an appellee, or who is an auditor or an auditee. A tax dispute is inherently a taxpayer asserting that he is not liable for a tax and the Government insisting that he is. The reasons of public policy which would make proper a discretionary award of fees are thus present or not present in a given tax controversy regardless of the formal position of the parties.

We agree with the conclusions reached by several other courts that these statements, made three months after the passage of Pub. L. No. 94–559, are little more than an expression of Senator Allen's personal opinion and are of slight value in construing the intent and meaning of the statute. *In re Kline*, 429 F. Supp. 1025, 1026–27 (D. Md. 1977); *Key Buick Co. v. Commissioner*, 68 T.C. 178, 183 (1977), *appeal pending; Lieb v. United States*, No. 75–81–C, slip op. at 2 (E.D. Okla. Sept. 29, 1977); *cf. United States v. Philadelphia National Bank*, 374 U.S. 321, 348–49 (1963) (views of members of subsequent legislatures upon intent of prior legislatures in passing statute entitled to little weight); *Fogarty* v. *United States*, 340 U.S. 8, 13–14 (1950).

We do not feel that Senator Allen's belated remarks provide a compelling reason to go beyond the ordinary meaning of the language of the provision, or the position taken by the participants in the actual debate. *See Selman v. United States*, 204 Ct. Cl. 675, 680, 498 F.2d 1354, 1356 (1974); *Benton v. United States*, 203 Ct. Cl. 263, 269, 488 F.2d 1017, 1020 (1973). His views were not addressed to the attention of the members of Congress before they voted on the Act; indeed, statements directly to the contrary were made by Representative Drinan prior to the House vote on the Act.[10] The Senator's statement would indicate that the procedural posture of the parties is irrelevant; that interpretation would render meaningless the language "by or on behalf of the United States." It is a fundamental maxim that a statute should, if possible, be construed so as to give effect to all parts of the statute rather than render some of the language superfluous or nugatory. *United States v. Menasche*, 348 U.S. 528, 538–39 (1955); *Jamerson v. United States*, 185 Ct. Cl. 471, 475, 401 F.2d 808, 810 (1968); *Tabor v. Ulloa*, 323 F.2d 823, 824 (9th Cir. 1963); 2A C. Sands, Sutherland Statutory Construction § 46.06 (4th ed. 1973). Moreover, the discussions and comments by various members of both Houses of Congress on the Act in general and in the committee reports (which themselves do not discuss the Allen amendment) indicate that the question of whether a party was a plaintiff or defendant was a matter of considerable concern to members of Congress; substantial attention was paid to the fact that different standards were to apply in the awarding of fees to plaintiffs as opposed to defendants.[11] From the discussions on the floor it would appear that Senator Allen's amendment was considered in the same light as the rest of the

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[10] See text accompanying note 8 *supra*.

[11] The language of the Act nowhere adverts to differing standards for making awards to plaintiffs in contrast to defendants; however, the legislative history would indicate that Congress was looking to past judicial practice. 122 Cong. Rec. S17050–51 (daily ed. Sept. 29, 1976) (Senators Tunney and Kennedy); 122 Cong. Rec. H12159–66 (daily ed. Oct. 1, 1976) (Representatives Drinan, White, Kastenmeier, Railsback, and Seiberling); S. Rep. No. 94–1011, 94th Cong., 2d Sess. 4–5, *reprinted in* [1976] U.S. Code Cong. & Ad. News 5908, 5912; H.R. Rep. No. 94–1558, 94th Cong., 2d Sess. 6–7 (1976).

Act.[12] There is no reason for believing that the other members of Congress regarded all tax suits as equivalent under the Allen amendment, given its wording.

In addition, Senator Allen's highly expansive definition of a "proceeding" as including tax audits certainly goes beyond anything that was contemplated in the discussions on the floors of Congress. The chief concern of Congress in enacting S. 2278 was to restore to the courts the ability to award attorneys' fees to prevailing parties and to undo, in part, the effect of the Supreme Court's decision in *Alyeska Pipeline Service Co. v. Wilderness Society, supra,* 421 U.S. 240 (1975). The language of Senator Allen's amendment merely tracks the same language "action or proceeding" that appeared in the original S. 2278 before amendment, which was concerned solely with litigation in courts. Senator Allen's remarks in introducing his amendment were also addressed to the award of attorneys' fees by a court in cases where the IRS brought a civil action and did not prevail. Nothing was intimated at that time, to the other members of the Senate before passage of the bill, of a broader meaning for "proceeding" than an actual suit before a court. *Key Buick Co., supra,* 68 T.C. at 184.

The plaintiff contends that the United States did in effect bring a suit against the taxpayer; that the agreement entered into by the parties that the determination on the question of liability for the 1970 Federal Unemployment tax would be binding on the parties in regard to the other employment taxes not before the court was tantamount to a counterclaim;[13] and that to this extent there was an

[12] Senator Kennedy's remarks discussing the Allen amendment in connection with standards for prevailing defendants as analyzed in the House and Senate reports demonstrate clearly the fact that the Allen amendment was contemplated in the context of the entire Act, as do Representative Drinan's remarks. *See* text accompanying notes 7 and 8 *supra.*

In this regard, it might be noted that Senator Allen's remark on January 14, 1977 that "the court need not determine that the Government has harassed the taxpayer nor need the court determine that the Government has in some way acted in bad faith" (123 Cong. Rec. S731 (daily ed. Jan. 14, 1977)) in order to award attorneys' fees is also considerably at variance with much of the discussion cited in note 11 *supra.*

[13] The parties had agreed that the determination of the court with respect to the 1970 Federal Unemployment taxes would be binding in regard to the remaining asserted liabilities, totalling $2,351,523.12. At oral argument, the plaintiff's attorney explained that the Government had not made a counterclaim because an assessment for that amount would have prevented the plaintiff from obtaining the loan

action or proceeding "by or on behalf of" the United States. The answer to this, however, is that in fact there was no counterclaim. The parties had agreed not to present the issue of liability in regard to the remaining taxes to the court. The statute contemplates the award of attorneys' fees only in connection with litigation before a court. Since no counterclaim was in fact presented to this court, we need not and do not reach the question of whether attorneys' fees could be awarded to a plaintiff who prevails on a tax counterclaim when the Government asserts such a counterclaim before the court.[14] Likewise, we do not have to reach the question of the appropriate standards under which such fees should be awarded.

The plaintiff also seeks the award of costs as authorized under 28 U.S.C. § 1920 (1970). However, it is the customary practice of this court to deny costs to either party. *Rasmussen v. United States*, 211 Ct. Cl. 260, 275, n. 20, 543 F.2d 134, 142 n.20 (1976). We therefore deny the plaintiff's motion for costs including attorneys' fees and expenses.

Nichols, *Judge*, concurring, also joins in the opinion of Judge Davis:

Judge Davis' analysis is correct, and I join in it, but I would have gone further and squarely faced up to this fact: the Allen amendment, as construed by the court, accomplishes an insignificant result, unworthy of the attention devoted to it by the Congress in debate. This is because, when the Government asserts and the taxpayer denies a liability for a tax, the Internal Revenue laws are so framed that it is the taxpayer who must sue. The Government need not do so. If the taxpayer should wait for the Government to sue him, he would allow the assessment to

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financing it required in order to carry on its seasonal business.

[14] In *Patzkowski v. United States*, No. C 75-2002 (N.D. Iowa, filed May 9, 1977), *appeal pending*, a taxpayer's refund suit, the court denied the prevailing plaintiff the award of attorneys' fees, though the Government had made a counterclaim. The court held the counterclaim to be an action within the meaning of The Civil Rights Attorney's Fees Awards Act of 1976, but found that there was no bad faith involved in the bringing of the counterclaim and that the award of attorneys' fees was therefore inappropriate.

become final, and his right to contest his liability would be gone forever.

This is an elementary fact of life to the tax lawyer, but it may have been unknown to the distinguished statesmen who adopted the amendment. I find this more probable than that they were legislating tongue in cheek. It may have been the first supposition with some members, the second with others. That the amendment was a hasty floor improvisation, not studied in committee, further supports the conclusion that its sponsors at least expected it to have more impact than it has.

It is a well-known maxim that in construing a statute courts may not say to Congress: "We see what you meant, but you have not used the right technical language to express your intent." To me the ultimate issue for us to decide is whether that maxim is for application in this case.

My answer is no. The Allen amendment is a statute enlarging the liability of the United States to pay money on court judgments, *i.e.*, waiving not only the *Alyeska* rule against attorneys' fees, but also the sovereign immunity of the United States. The entire history of the jurisdiction of this court establishes and illustrates that for a claim to be enforceable under any such statute, it must (a) come within the spirit and intent of the statute, and (b) within its literal language technically construed. In this instance, if we agree Congress intended more than it enacted, it is hard to say how much more; Mr. Allen's post-enactment statement only adds confusion as to that. Thus the claim for attorney's fees here may not even pass the first test, but in any case, it fails the second. Congress has the Internal Revenue laws constantly under its eye, and if it wants harassed taxpayers to recover their counsel fees and other court costs, it will, if it employs its usual deliberative process, know how to say so in a technically correct manner. For us to try to do it would be legislation beyond our jurisdiction to enact. The Allen amendment is more an expression of disgruntlement with the tactics of some revenue agents than it is an effective piece of legislation, and we need feel no qualms of conscience in giving it scant operative effect.

Syllabus

571 F.2d 21

FIRST NATIONAL BANK OF OREGON, DULY APPOINTED EXECUTOR OF THE ESTATE OF BERTHA E. CHAMBERS AND TRUSTEE OF THE BERTHA E. CHAMBERS CHARITABLE REMAINDER UNITRUST v. THE UNITED STATES

[No. 135–77. Decided February 22, 1978]

ON THE PARTIES' CROSS-MOTIONS FOR SUMMARY JUDGMENT

Taxes; taxable estate; charitable transfer; charitable deduction allowance; interest on overpayment.—Decedent, who died in September 1973, left a will providing that a charitable trust be established with decedent's sister and two charities designated as income beneficiaries and one of these charities designated as residual beneficiary. The charitable bequests could not be deducted from the gross estate as charitable contributions because the trust did not qualify under 26 U.S.C. § 2055(e)(2)(A). In 1974 Congress enacted 26 U.S.C. § 2055(e)(3) which, with respect to wills executed before September 21, 1974 creating charitable remainder interests unqualified for deductions under Sec. 2055(e)(2)(A), permitted reformation thereof to meet the requirements of that section. The new section also provided that if a refund were payable because of reformation, interest could not be recovered prior to expiration of the 180th day after the claim for refund was filed. Plaintiff obtained reformation of the will's trust provision so that the bequests to the charities would be deductible in computing the Federal estate tax due. The Internal Revenue Service denied plaintiff interest on the overpayment resulting from the reformation, and plaintiff seeks to recover the interest in this action, claiming that the interest limitation is unconstitutional in violation of equal protection of the law. It is *held* that the provision withstands plaintiff's attack since it is rationally justifiable. Defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied, and the petition is dismissed.

Constitutional law; equal protection of the law; classification; basis for classification.

[1] In determining whether a statute, in its classification of persons designated therein, violates the equal protection clause of the Fifth Amendment, the test is whether the classification is reasonable, not arbitrary, and rests upon some ground of difference having a fair and substantial relation to the object of the legislation so that all persons similarly circumstanced shall be treated alike. A statutory discrimination will not be set aside if any state of facts reasonably may be conceived to justify it.

Constitutional Law ⊜211(2)

Taxes; statutes; new enactment.

[2] The fact that the Treasury Department did not limit payment of interest in its regulations between 1969–1973 does not prevent Congress from imposing appropriate restriction when it enacts a piece of purely remedial legislation, such as 26 U.S.C. § 2055(e)(3)(Supp. V, 1975), in order to benefit a taxpayer or a charitable remainder interest designated by the taxpayer, and at the same time limits the expense the Government must undergo in effectuating the benefit.

Internal Revenue ⚖40

Taxes; estate tax; taxable estate; transfers for public, charitable and religious uses; charitable deduction allowance; interest on overpayment.

[3] Under 26 U.S.C. § 2055(e)(3)(Supp. V, 1975), which allows reformation of a will creating charitable remainder interests unqualified for deductions under Sec. 2055(e)(2)(A), the provision that interest on a refund may not be recovered until 180 days after the refund claim is filed is not violative of the equal protection clause of the Fifth Amendment where it satisfies the "minimum rationality" standard. This court does not sit as a superlegislature to judge the wisdom or desirability of a challenged provision.

Constitutional Law ⚖229.1
Internal Revenue ⚖40

William J. Lehrfeld, attorney of record for plaintiff. *Webster & Chamberlain,* of counsel.

Patricia B. Tucker, with whom was *Assistant Attorney General M. Carr Ferguson,* for defendant. *Theodore D. Peyser* and *Donald H. Olson,* of counsel.

Before COWEN, *Senior Judge,* NICHOLS and BENNETT, *Judges.*

COWEN, *Senior Judge,* delivered the opinion of the court:

This case raises the issue whether the last sentence of 26 U.S.C. § 2055 (e)(3) (Supp. V. 1975) violates the equal protection clause of the 14th Amendment as included in the Fifth Amendment's due process clause.[1] The sentence in question will not permit interest to be paid to a taxpayer until 180 days after he has filed a claim for refund, if the refund is made possible by the reformation of a trust pursuant to section 2055(e)(3) for the purpose of permitting

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[1] The inclusion of the equal protection clause in the Fifth Amendment is now well settled. *Bolling v. Sharpe,* 347 U.S. 497 (1954); *Bruinooge v. United States,* 213 Ct. Cl. 26, 550 F.2d 624 (1977).

a charitable deduction in accordance with section 2055(e)(2)(A). We hold that the provision in issue withstands plaintiff's constitutional attack.

The case comes before us on cross-motions for summary judgment and the facts are not in dispute. Plaintiff is the executor of the estate of Bertha Chambers. Mrs. Chambers died on September 29, 1973, and left a will which was admitted to probate in Oregon. Under the terms of the will a charitable trust was to be established with the sister of the decedent and two charities designated as income beneficiaries and one of these charities designated as residual beneficiary. Under the will as written, the bequests to the charities could not be deducted from the gross estate as charitable contributions, because the trust was not a qualifying charitable remainder annuity trust, unitrust, or pooled income fund as required for charitable remainder deductions by 26 U.S.C. § 2055(e)(2)(A).[2] Therefore, after receiving extensions of 12 months within which to pay the estate tax due, plaintiff paid $583,401.40 in tax and $34,868.22 in 12-month assessed interest to the Internal Revenue Service (IRS).

In 1974, however, Congress enacted 26 U.S.C. § 2055(e)(3) which, in the case of wills executed before September 21, 1974, creating charitable remainder interests unqualified for deductions under section 2055(e)(2)(A), permitted reformation of these wills to meet the requirements of that section. In accordance with section 2055(e)(3), plaintiff obtained a reformation of the trust provisions in Mrs. Chambers' will so that the bequests to the charities would be deductible in computing the Federal estate tax due. Plaintiff and the IRS agreed that the refund of tax due as a consequence of the reformation of the trust and resultant increase in allowable deductions was $229,079.[3]

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[2] For a further discussion of this provision and its background, see this court's opinion in *Ellis First Nat'l Bank v. United States*, 213 Ct. Cl. 44, 48, 550 F.2d 9, 11 (1977).

[3] In its petition to this court, plaintiff claimed that the IRS, when it agreed to refund $229,079 out of the $583,401.40 tax originally paid, did not agree to refund a correct percentage of the $34,868.22 in interest paid on account of plaintiff's 12-month delay in paying the estate tax due. In its brief and at oral argument, plaintiff has abandoned this claim.

What plaintiff contests in this court is the constitutionality of the last sentence of section 2055(e)(3) on which the IRS relied to deny plaintiff interest on its $229,079 overpayment for the first 180 days after plaintiff filed its claim for refund. The sentence provides:

> * * * In the case of a credit or refund as a result of an amendment or conformation made pursuant to this paragraph, no interest shall be allowed for the period prior to the expiration of the 180th day after the date on which the claim for credit or refund is filed.

Plaintiff claims that this provision, applicable to wills executed or trusts created before September 21, 1974, and amended by December 31, 1977,[4] is arbitrary and illogical when contrasted with the prior policy of the Department of the Treasury. In 1969, when it enacted section 2055(e)(2)(A), Congress generally allowed a deduction under prior law in the case of wills executed on or before October 9, 1969, or trusts created before that date, if the donor died before October 9, 1972, without having changed such will or trust. Tax Reform Act of 1969, Pub. L. 91–172, § 201(g)(4), 83 Stat. 487. The Treasury Department subsequently issued regulations to minimize the adverse tax impact of section 2055(e)(2)(A) on improperly drawn instruments executed after July 31, 1969, and amended to conform with section 2055(e)(2)(A) on or before December 31, 1972. These regulations provided that unqualified charitable remainders created and reformed to qualify during this period of time would be treated as qualified "for all purposes" from the date of their original creation. Treas. Reg. § 1.664–1(f)(3), 26 C.F.R. § 1.664–1(f)(3) (1973). Thus, just as under present section 2055(e)(3), if estate taxes were overpaid by an estate in this situation, the overpayment would be refunded. The salient factor in the case at bar, however, is that any claims for refund pursuant to these Treasury regulations affecting instruments drawn and reformed between 1969 and 1973 were

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[4] The reformation provision originally applied only to instruments amended by December 31, 1975. 26 U.S.C. § 2055(e)(3) (Supp. V. 1975). This date was extended to December 31, 1977, by section 1304(a) of the Tax Reform Act of 1976, Pub. L. 94–455, 90 Stat. 1520.

entitled to interest pursuant to 26 U.S.C. § 6611(a)[5] from the date of overpayment. Therefore, plaintiff contends that the current provision denying this interest for 180 days to estates amending instruments between 1973 and 1977, created a new special class of taxpayers who were denied full recovery of interest on their overpayments, contrary to the 1969–73 policy of the Treasury. Since plaintiff can perceive no logical reason for this change in policy, it contends the new class of taxpayers has been denied equal protection of the laws.[6]

The merits of plaintiff's argument need not detain us unduly. We do not sit as a superlegislature to judge the wisdom or desirability of the challenged provision. *New Orleans v. Dukes*, 427 U.S. 297, 303 (1976); *Ferguson v. Skrupa*, 372 U.S. 726, 731 (1963); *Day-Brite Lighting, Inc. v. Missouri*, 342 U.S. 421, 423 (1952). As long as a suspect classification, such as race, or an area of intermediate scrutiny, such as sex, is not involved, the test to be applied to the challenged provision is the following:

> * * * the classification must be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike. * * * (*Royster Guano Co. v. Virginia*, 253 U.S. 412, 415 (1920)).

Johnson v. Robison, 415 U.S. 361, 374–75 (1974); *Bruinooge v. United States*, 213 Ct. Cl. 26, 30, 550 F.2d 624, 627 (1977); *Fredrick v. United States*, 205 Ct. Cl. 791, 797, 507 F.2d 1264, 1266 (1974). This is the so-called "minimum rationality" or "conceivable basis" standard. The Supreme Court has variously phrased the test as mandating that a "statutory discrimination will not be set aside if any state of facts reasonably may be conceived to justify it." *McGowen v. Maryland*, 366 U.S. 420, 426 (1961); *Dandridge v. Williams*, 397 U.S. 471, 485 (1970).

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[5] The provision reads: "Interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax at an annual rate established under section 6621." 26 U.S.C. § 6611(a) (Supp. V 1975).

[6] Plaintiff also claimed in its petition to this court that the interest limitation in section 2055(e)(3) constituted a taking without just compensation in violation of the Fifth Amendment. In its brief, plaintiff has abandoned this claim.

In one case, *Morey v. Doud*, 354 U.S. 457 (1957), the Court found an economic regulation to be an arbitrary classification violative of equal protection. An Illinois statute did not permit "currency exchanges" to sell money orders at drug stores or grocery stores, and yet exempted the American Express Company from the restriction, apparently because the Company was an enterprise of unquestioned solvency and high financial standing. The Supreme Court invalidated this classification as arbitrary in the *Morey* decision, but in a recent case, the Court expressly overruled that decision. In *New Orleans v. Dukes*, 427 U.S. 297, 306 (1976), the Court stated:

> * * * *Morey* was the only case in the last half century to invalidate a wholly economic regulation solely on equal protection grounds, and we are now satisfied that the decision was erroneous. * * *

We are not aware of any Supreme Court decision in recent years holding that a Federal tax regulation subject to a "minimum rationality" test is violative of the equal protection clause.[7] Moreover, the Court's decision in *New Orleans, supra*, seems to clarify that at least with regard to Federal tax regulations and other economic regulations, a

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[7] *See, e.g., United States v. Maryland Savings-Share Ins. Corp.*, 400 U.S. 4, 6 (1970). Plaintiff, however, in response to a question at oral argument in the case at bar, proffered *WHYY v. Borough of Glassboro*, 393 U.S. 117 (1968), as the strongest support for its argument that the tax provision in question before this court violates equal protection. The plaintiff there challenged a New Jersey statute which exempted New Jersey nonprofit corporations from state real and personal property taxes while denying the same benefit to a foreign nonprofit corporation operating in New Jersey. The Court stated, in finding the statute did violate equal protection, that it was following a rule which

> "* * * has consistently held that while a State may impose conditions on the entry of foreign corporations to do business in the State, once it has permitted them to enter, 'the adopted corporations are entitled to equal protection with the state's own corporate progeny, at least to the extent that their property is entitled to an equally favorable *ad valorem* tax basis.' " [*Id.* at 119].

This long-held rule of the Supreme Court, that state taxes which discriminate against an out-of-state transactor in favor of some local interest violate equal protection, is not applicable to the Federal tax regulation challenged at bar. The policy of disallowing discriminatory state taxes is consistent with other Supreme Court rules which prevent burdens on the free flow of interstate commerce. On the other hand, the only policy which applies to the case at hand is the long-held policy, discussed above in the text, against invalidating a Federal tax or other economic regulation as violative of equal protection.

Federal court has very little room for disapproval of them if any "state of facts reasonably" justifies them. *Id.*

In fact, as we intimated in our decision in *Bruinooge, supra* (213 Ct. Cl. at 29, 550 F.2d at 626), when a Federal tax regulation is involved it is possible that the regulation may indeed be arbitrary and still withstand an equal protection challenge. Mr. Justice Brennan, in his recent opinion for the Court in *Commissioner v. Kowalski*, 434 U.S. 77, 95–96 (1977), remarked:

> * * * arguments of equity have little force in construing the boundaries of exclusions and deductions from income many of which, to be administrable, must be arbitrary. * * *

However, we need not decide this further question, for the interest limitation in issue before this court is rationally justifiable.

We will not explore all of the reasons the Government advances for justification of the provision in order to reach our decision. We accept the Government's argument that section 2055(e)(3) is a wholly remedial provision, and that the limitation on interest is an appropriate restriction on a grace period provided by Congress for reformation of wills and trust provisions by the estates of those persons who failed to rewrite their wills after 1969 to comply with section 2055(e)(2)(A). The fact that the Treasury Department did not limit the payment of interest in its regulations between 1969–73 does not prevent Congress from imposing an appropriate restriction when it enacts a piece of purely remedial legislation in order to benefit a taxpayer or, more particularly, a charitable remainder interest designated by the taxpayer.

Plaintiff has attempted by the following arguments to circumvent the long-standing precedent against invalidating on equal protection grounds a Federal tax regulation such as the one in question here. First, plaintiff argues that the interest limitation is irrational, because the purpose of section 2055(e)(3) was to protect charitable beneficiaries of certain unqualified charitable remainder trusts rather than to penalize them by limiting their right to interest. This argument has no merit. There is nothing irrational about a law which provides remedial legislation for

charitable beneficiaries, and at the same time limits the expense the Government must undergo in effectuating these benefits.

Second, plaintiff contends the classification in question must further a "legitimate" state purpose, meaning that it is not enough for a court to find *some* rational basis to uphold the classification. Plaintiff cites *McGinnis v. Royster*, 410 U.S. 263, 270 (1973), for this proposition. A careful reading of the *McGinnis* decision, however, reveals the Court's actual ruling that the "appropriate standard" for decision is that the legislative classification in question needs "only *some* rational basis" to be sustained. (emphasis added) *Id.*

Third, plaintiff again cites *McGinnis* for the proposition that the rational basis on which the classification is upheld must be "articulated." Plaintiff intimates that unless the rational basis is articulated in the legislative history of the statute itself, the challenged provision cannot meet constitutional muster. This has never been the holding of the Supreme Court, and it is not the holding of *McGinnis*. The *McGinnis* decision itself appears to rely mainly on rational bases enunciated by the state in its brief and at oral argument, not on the legislative history of the classification in question there. *Id.* In the absence of legislative history, the methodolgy which this court recently used in determining whether a challenged provision such as the one here violates equal protection is set out in *Bruinooge*, (213 Ct. Cl. at 31, 550 F.2d at 627): "* * * we try to devine what Congress left unstated [and] we resort to our own talents and those of counsel to discern" the rationality of the classification in question.

As we have shown, the law in the challenged area of equal protection analysis has been well-settled for many years now.[8] Therefore, for the reasons set out in our opinion above, the Government's motion for summary

[8] In a recent action involving this identical issue in the United States District Court for the District of New Hampshire, Judge Bownes saw so little merit in the plaintiff's contentions that he dismissed them with one sentence:

"* * * The provision to the extent that it sets up a separate class is reasonable and must be considered together with the special deduction which it created."

Merchants Nat'l Bank v. United States, Civil Action No. 76-275 (Nov. 29, 1977).

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judgment is granted, and the plaintiff's petition is dismissed.

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573 F.2d 31

ABRAHAM D. GOSMAN v. THE UNITED STATES

No. 147–73

LEONARD SCHWARTZ AND ABRAHAM D. GOSMAN v. THE UNITED STATES

No. 188–73

WYNDOVER CONVALESCENT HOSPITAL, INC. v. THE UNITED STATES

No. 189–73

[Decided February 22, 1978. Plaintiffs' motion for rehearing and amendment of judgment was denied April 27, 1978.]

ON PLAINTIFFS' AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; Medicare contract; reimbursement for provider costs; gains and losses on sale of assets; depreciation; goodwill; advertising costs; unamortized deferred financing charges; interest expenses.—During various periods from 1967 to 1969 plaintiffs owned and operated nursing facilities qualifying as providers of services under the Medicare Act. Plaintiffs entered into various sales agreements, and upon termination of their Medicare program participation, they submitted cost reports to the fiscal intermediary which disallowed some of the claims for reimbursement. The Hearing Panel sustained most of the disallowances. In these consolidated cases, plaintiffs contest several of the Panel's rulings. On the basis of the evidence before the Panel, it is *held* (1) that the Panel properly rejected depreciation that had been previously allowed as a reimbursable cost because of gains attributed to the depreciable assets as a result of the sale; (2) that the Panel properly found no goodwill involved in the sale; (3) that the advertising costs incurred by plaintiffs were not reimbursable because they were not directly related to Medicare patient care; (4) that the relevant guidelines of the Provider Reimbursement Manual are interpretative and not substantive and their application is not violative of 5 U.S.C. § 553; (5) that the Panel was not arbitrary or capricious in reducing the sale price by the advertising costs on the basis of plaintiff's explanation thereof; (6) plaintiffs are not entitled to an allowance as a reimbursable cost of the unamortized balance of the deferred financing charges in the

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accounting periods in which the sales occurred, but are only entitled to the amounts amortized during the cost periods; and (7) that by reason of certain interest-free loans made by plaintiffs to related enterprises, a portion of the interest expenses incurred on loans necessary to satisfy the providers' financial needs was properly disallowed. The parties' motions for summary judgment are allowed and denied consonant with the opinion. The cases will be returned to the Panel for computation of the amounts due defendant and the plaintiffs. Dismissal of the petitions is deferred pending the administrative proceedings.

Court of Claims jurisdiction; Medicare Act; review of provider reimbursement disputes.

[1] While the Court of Claims has jurisdiction over Medicare provider disputes involving cost reporting periods prior to June 30, 1973, its scope of review is limited to examination of decisions of the Hearing Panel for compliance with the Constitution, statutory provisions, and regulations having the force and effect of law, as well as for taint of arbitrariness, capriciousness, or lack of support in substantial evidence.

Social Security and Public Welfare ⚖241.50

Constitutional law; due process; Medicare program; composition of Hearing Panel.

[2] A provider of medicare services in a reimbursement dispute is not deprived of due process because the members of the Panel were employees of the fiscal intermediary.

Constitutional Law ⚖318(2)

Contracts; Medicare contract; reimbursement for provider costs; gains and losses on sale of assets; depreciation.

[3] Where the Hearing Panel in determining gain on the sale of the depreciable assets apportioned the total sale price of each facility to each of the individual assets in accordance with the ratio of the historical cost of each asset to the total historical cost of all of the assets as the most appropriate measure, under the controlling standard for judicial review of this administrative factual determination the Panel acted permissibly in rejecting previously allowed depreciation because of gains on the sale of the depreciable assets pursuant to 20 C.F.R. § 405.415(f).

Social Security and Public Welfare ⚖241.10

Contracts; Medicare contract; reimbursement for provider costs; cost data; burden of proof.

[4] Providers receiving payment on the basis of reimbursable costs must provide adequate cost data; this obligation cannot be shifted to defendant when the provider's data proves inadequate.

Social Security and Public Welfare ⚖241.35

Contracts; Medicare contract; reimbursement for provider costs; gains and losses on sale of assets; start-up costs as goodwill.

[5] Where the parties' books did not show certain of the seller's start-up costs, previously incurred and expensed, as bargained-for goodwill, the Hearing Panel's determination that goodwill was not involved in the sale of the subject facilities was not arbitrary, particularly where little

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evidence was presented to the Panel affording a sound determination of the existence of fair market value of goodwill.

Social Security and Public Welfare ⚖241.35

Contracts; Medicare contract; reimbursement for provider costs; costs related to patient care; advertising costs.

[6] 42 U.S.C. § 1395x(v)(1)(1970) and 20 C.F.R. § 405.451 are reasonably read as precluding reimbursement of such indirect expenditures only tangentially or speculatively related to the actual care of Medicare beneficiaries. It follows that § 2136.2 of the Provider Reimbursement Manual HIM–15 which specifically disallows costs of advertising directed to the general public for purpose of increasing occupancy of the facilities is inconsistent with neither the statute nor the overriding regulation.

Social Security and Public Welfare ⚖241.10

Contracts; Medicare contract; reimbursement for provider costs; guidelines; substantive v. interpretive.

[7] Since 20 C.F.R. § 405.451 could reasonably be understood as, in itself, forbidding reimbursement of certain costs incurred by a provider in connection with advertising, the relevant provision of the Provider Reimbursement Manual HIM–15 explaining what the general terms of the statute and regulation required effected no change in policy, in the law or deprived the provider of a preexisting right; as such the provision was merely interpretative and not substantive. Accordingly, retroactive application of the Manual guidelines was lawful and not violative of 5 U.S.C. § 553.

Social Security and Public Welfare ⚖241.10

Regulations of Executive Department; guidelines; agency characterization.

[8] An agency's characterization of its guidelines as procedural and interpretative is not controlling in determining whether they comply with 5 U.S.C. § 553 requiring notice in the Federal Register with opportunity for comment.

Administrative Law and Procedure ⚖394

Contracts; Medicare contract; reimbursement for provider costs; gains and losses on sale of assets; unamortized deferred financing charges.

[9] Where there are several acceptable accounting methods, the judgment of HEW as to which method most appropriately implements the principles of reimbursement under the Medicare program as set forth in its regulations and guidelines is entitled to deference. The decision of the Hearing Panel permitting only those amounts (of the deferred financing charges incurred in acquiring mortgage financing) amortized during the cost periods in question and offsetting the unamortized balance against the sale price of the facilities, was an acceptable method of accounting based on HIM–15 § 204 which, since it made no change in preexisting law, was not retroactive in its application.

Social Security and Public Welfare ⚖241.10

Contracts; Medicare contract; reimbursement for provider costs; gains and losses on sale of assets; interest expenses and sums lent on equity capital.

[10] 20 C.F.R. § 405.419(b)(2) permits, as a reimbursable expense, only interest on loans necessary to satisfy the financial need of the provider and related to patient care. Where plaintiffs' books revealed interest-free loans to related facilities and plaintiffs incurred interest expense on mortgages on the facilities, it was appropriate for the Hearing Panel to adjust the amount of interest includable as allowable costs to reflect the interest expense which could have been saved had plaintiffs used the sums loaned to related facilities to reduce the need for mortgage financing. The same is true for the exclusion of sums lent as equity capital which the statute, regulations and HIM–15 limit to amounts related to patient care.

Social Security and Public Welfare ⚖241.10

Richard H. Gens, attorney of record, for plaintiffs. *Leppo and Paris,* of counsel.

Arlene Fine, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant. *Leila Carp,* of counsel.

Before COWEN, *Senior Judge,* DAVIS and KUNZIG, *Judges.*

DAVIS, *Judge,* delivered the opinion of the court:

These are consolidated Medicare provider cases which come before the court on the parties' cross-motions for summary judgment. Plaintiff Abraham D. Gosman owned and operated four nursing homes (Abbet Manor, Hamilton Pavilion, Nutmeg Pavilion, and Parkway Pavilion) as sole proprietorships. He and plaintiff Leonard Schwartz operated another such facility (Danbury Pavilion) as a partnership. Plaintiff Wyndover Convalescent Hospital, Inc. also operated the same kind of facility. All of these nursing homes were extended care facilities under the Medicare Act, 42 U.S.C. § 1395x(j) (1970) and were providers of services within the meaning of 42 U.S.C. § 1395x(u) (1970),[1]

[1] For brief descriptions of the rights and obligations of Medicare providers, *see Whitecliff, Inc. v. United States,* 210 Ct. Cl. 53, 536 F.2d 347 (1976), *cert. denied,* 430 U.S. 969 (1977); *Overlook Nursing Home, Inc. v. United States,* 214 Ct. Cl. 60, 556 F.2d 500 (1977); *Ulman v. United States,* 214 Ct. Cl. 308, 558 F.2d 1 (1977); and *St Elizabeth Hospital v. United States,* 214 Ct. Cl. 332, 558 F.2d 8 (1977).

References to the Medicare Act provisions, 42 U.S.C. §§ 1395h, 1395x (1970), are to the provisions as they stood before amendment in 1972 pursuant to the Social

participating in the Medicare Program during various periods from 1967 to 1969. The Wyndover home was sold on May 31, 1967; the others were transferred under a sales agreement executed on June 28, 1968. The transfer of the facilities terminated the provider agreements pursuant to 20 C.F.R. § 405.625 (1970). Upon this termination of their participation in the program, all of the facilities submitted cost reports to the Travelers Insurance Company, which had been nominated by them as their fiscal intermediary under 42 U.S.C. § 1395h (1970). After the cost reports submitted by the providers had been audited by certified public accountants, the fiscal intermediary disallowed some of the claims for reimbursement. In June 1973 the plaintiffs filed suit in this court without seeking administrative review; after suspension of proceedings pursuant to an order of this court dated September 19, 1973, a consolidated administrative hearing was held on December 5, 1974. In November 1975 the Hearing Panel sustained most of the disallowances made by the fiscal intermediary, but ruled on a few items in favor of the plaintiffs. The suit then continued here with the plaintiffs contesting several of the Hearing Panel's rulings via their motion for summary judgment, and the defendant, in its motion, supporting the Panel except in one of the aspects in which the decision went for the plaintiffs.

The defendant again challenges this court's jurisdiction, but we adhere to our prior opinions in which we have held that we have jurisdiction over these Medicare provider cases involving cost reporting periods prior to June 30, 1973. *See, St. Elizabeth Hospital v. United States,* 214 Ct. Cl. 332, 558 F.2d 8, 11 (1977); *Overlook Nursing Home, Inc. v. United States,* 214 Ct. Cl. 60, 64–65, 556 F.2d 500, 502 (1977); *Whitecliff, Inc. v. United States,* 210 Ct. Cl. 53, 56–58, 536 F.2d 347, 349–51 (1976), *cert. denied,* 430 U.S. 969 (1977). By the same token it is settled that our scope of review in this type of case is limited; the decisions of the Hearing Panel are to be examined for compliance with the Constitution, statutory provisions, and regulations having

Security Amendments of 1972, Pub. L. No. 92–603, 86 Stat. 1329. References to the Code of Federal Regulations are to the 1970 edition. No substantive changes were made to the applicable provisions during the cost periods in issue.

the force and effect of law, as well as for the taint of arbitrariness, capriciousness, or lack of support in substantial evidence. *St. Elizabeth Hospital, supra,* 214 Ct. Cl. at 326–27, 558 F.2d at 11–12; *Ulman v. United States, supra,* 214 Ct. Cl. 308, 313, 558 F.2d 1, 3 (1977); *Overlook Nursing Home, Inc., supra,* 214 Ct. Cl. at 65, 556 F.2d at 502; *Whitecliff, Inc., supra,* 210 Ct. Cl. at 58, 536 F.2d at 351. Our scrutiny is analogous to the review in Government contract cases under the Wunderlich Act, 41 U.S.C. §§ 321–22 (1970). *Overlook Nursing Home, supra.*

I

The plaintiffs first contend that the composition of the Hearing Panel was inherently violative of due process, since two of the three members of the panel were employees of the fiscal intermediary. We dealt with the identical contention in *Overlook Nursing Home, Inc., supra,* 214 Ct. Cl. 60, 556 F.2d 500; in the absence of any allegation of actual bias, the court held against the plaintiff. Since there are no indications of any actual bias in the case at bar, the *Overlook* ruling controls.

II

The claimants' primary substantive assault on the administrative determination is that the Hearing Panel improperly rejected depreciation that had been previously allowed as a reimbursable cost, because of gains that were attributed to the depreciable assets as a result of the 1968 sale of the nursing homes. 20 C.F.R. § 405.415(f) (1970) provides in essence for the recoupment by the Government of payments made to providers to the extent the payments are based on depreciation which proves to be excessive upon the sale of the depreciable assets.[2] For this case the

[2] 20 C.F.R. § 405.415(f) (1970) reads as follows:

"*Gains and losses on disposal of assets.* Gains and losses realized from the disposal of depreciable assets are to be included in the determination of allowable cost. The extent to which such gains and losses are includable is to be calculated on a proration basis recognizing the amount of depreciation charged under the program in relation to the amount of depreciation, if any, charged or assumed in a period prior to the provider's participation in the program."

application of that regulation depends on the allocation of the sales price to the various transferred assets. The parties to the sales agreements had made no agreement on the allocation of the total sales price of each nursing home to the underlying assets (*i.e.*, the land, buildings, and equipment) of each facility. Likewise, the plaintiffs did not provide the fiscal intermediary with evidence as to the fair market value of the individual assets at the time of the sales. In order to determine the gain on the depreciable assets, the intermediary apportioned the total sale price of each facility to each of the individual assets in accordance with the ratio of the historical cost of each asset to the total historical cost of all of the assets.[3] As a result of this allocation, the gains on the depreciable assets were found to exceed the depreciation taken, and therefore the intermediary disallowed all of the depreciation that had been taken as a reimbursable cost on the facilities.

The providers first say that the Hearing Panel, in basically confirming the intermediary's determination, wrongly interpreted 20 C.F.R. § 405.415(f) (1970), *supra*, to require all of the gains arising from the sales to be automatically applied as an offset to depreciation on the depreciable assets, thereby creating a new substantive rule which gives rise to serious issues under the Administrative Procedure Act, 5 U.S.C. § 553 (1970) and the Due Process clause because of the retroactive application of the alleged new rule. We agree, however, with the defendant that that is not a *bona fide* issue in this case. The Hearing Panel established no such new rule, but merely regarded the evidence offered by the plaintiffs to it as unpersuasive on the valuation of the various kinds of assets. On this record the question is factual, not legal, and our task is to decide whether the Panel's adverse determination was unsupported by substantial evidence, arbitrary, or capricious.

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[3] The fiscal intermediary, after allocating the total sales price to each class of assets, then deducted from the price allocated to each class of assets certain unamortized finance charges associated with that class of assets, in order to obtain a net sales price for each class of assets. These costs are in issue in another context in Part IV *infra*; the plaintiffs seek to charge off the entire unamortized portion of the finance charges as an allowable expense in the final periods of Medicare participation.

To sustain their claims in the depreciation matter, plaintiffs brought before the Panel, as evidence tending to show that the bulk of the gains on the sales were allocable to non-depreciable assets, the initial valuation of each class of assets by the buyer, tax schedules given by the plaintiffs to the Internal Revenue Service showing the original cost of the equipment and losses on the sale of it, state real estate tax conveyance forms which had no allocations of the amount declared between the land and the buildings, and a set of appraisals on the value of the land (but not the buildings) commissioned by the plaintiffs in 1974. None of this material convinced the Panel that the intermediary had erred.

Under the controlling standard for judicial review of such an administrative factual determination, we cannot say that the Panel acted impermissibly. It could properly decide that plaintiffs failed in their efforts to attribute all or the largest part of the gain to non-depreciable assets (mainly land and alleged goodwill), and that the historical cost method utilized by the intermediary remained the most appropriate measure.[4] The fact is that plaintiffs' allocations tended to verge on the incredible in their attempt to marshal the gain mostly for the land. Moreover, there were grave inconsistencies in the various valuations before the Panel,[5] and there was also something quite defective in each of the types of evidence proffered by the claimants.

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[4] Plaintiffs put forth as a procedural argument that, after they had supplied evidence in support of their valuations, the fiscal intermediary necessarily had the burden of going forward with evidence to disprove plaintiffs' valuations. There is nothing, however, in the statutes or regulations which places such an affirmative burden on the intermediary. The responsibility is upon the providers to furnish adequate accounting data. 20 C.F.R. § 405.453(a) (1970) declares that "Providers receiving payment on the basis of reimbursable cost *must* provide adequate cost data" (emphasis added). The obligation of supplying sufficient evidence cannot be shifted to the defendant where the provider's data proves inadequate. *See Overlook Nursing Home, Inc. v. United States, supra*, 214 Ct. Cl. at 70–71, 556 F.2d at 505–06.

[5] For instance, the buyer's valuations differed markedly from those of the plaintiffs; the latter valued the land about five times as high as the former (in the instances where data are available for comparison), while the buyer's equipment valuations exceeded plaintiffs'. In the case of Abbet Manor the equipment was valued by the buyer at $204,800, but by Gosman at only $145,260. The historical cost was $211,051 for Gosman, and the holding period was two years.

It is not an unfair summation of the record before the Hearing Panel to set forth the following table (prepared by defendant) which shows the percentage gains or losses resulting from the providers' claimed allocation to each class of asset:

Facility	*Holding Period*	*Total Gain on sale*	*Claimed Gain on Land*	*Claimed Gain (Loss) on Building*	*Claimed Loss on Equipment*
Abbet Manor	2 yrs.	72%	442%	62%	(29%)
Danbury	1 yr.	21%	250%	12%	(29%)
Nutmeg	11-1/2 mos.	30%	$238,000 [6]	5%	(39%)
Parkway	7-1/2 mos.	15%	581%	(3%)	(38%)
Hamilton	7 mos.	4%	172%	8%	(27%)

Under this allocation the total sales price of the (depreciable) equipment was less than the equipment's book value after depreciation.[7] On the other hand, the land (nondepreciable) gains are proportionately very large; in one instance there is an alleged rise of 581% for a holding period of only a little over seven months. It is said that Gosman testified that there had been zoning changes. There may have been but this does not gainsay the peculiarity of allocations resulting in such spectacular and varying appreciations on nondepreciable assets, while equipment held for a short time is reported as having considerable losses. We simply cannot say that either the fiscal intermediary or the Panel were unable to consider unreasonable plaintiffs' claims that the value of relatively new equipment would have declined below cost less

[6] No percentage gain on the land can be calculated in the case of Nutmeg Pavilion. Since the land was leased subject to an option to purchase in favor of the lessee, there was no historical cost.

[7] In the case of one facility, the amount allocated to equipment apparently did exceed the book value after depreciation. However, the total claimed losses on the equipment of all the facilities listed in the table did exceed the total depreciation taken on the equipment.

The plaintiffs (in their reply to the defendant's cross-motion for summary judgment) now urge that they accept the defendant's valuations for the buildings. However, this concession does not alter their claimed equipment allocations, which they presumably seek to establish by deducting the amounts listed on their real estate tax declarations from the total sale price for each facility.

depreciation, using a double declining balance method with less than standard estimated useful lives.

Moreover, the plaintiffs presented no consistent appraisals or valuations of the various classes of assets in relation to the sale price. *Cf. North Clackamas Community Hospital v. Matthews,* Civil No. 76–199 (D. Ore., filed Dec. 23, 1976) (permissible for Provider Reimbursement Board to use independent appraisal of separate assets, commissioned by parties unable to agree upon allocation of agreed-upon sale price, in preference to an appraisal commissioned subsequently by the plaintiff). There was not even a direct valuation of the equipment, and it is difficult to harmonize the differing figures for the real estate values and also for the equipment which result from the various formulae put forward by the providers. The Hearing Panel's refusal to accept the plaintiffs' own tax declarations as sufficient evidence of valuation was not arbitrary, given that the self-reporting system under the Internal Revenue Code with regard to the recapture of depreciation on equipment and buildings is likely to give rise to considerable self-serving bias. *See* I.R.C. §§ 1245, 1250; *cf.* 20 C.F.R. § 405.415(f) (1970). The same is true of the Connecticut tax conveyance forms filed by the providers and sought to be used to show value in the proceedings before the Hearing Panel.

As part of their claim that most of the sales gain was attributable to non-depreciable assets, plaintiffs press the contention that a substantial segment of the sale price should be allocated to goodwill,[8] since the sale agreement allegedly required on-going businesses with a minimum of 60 patients each (at the time of execution of the sale agreement some of the facilities were still under construction). One of the items which we are told should have been considered part of the goodwill was a certain set of start-up costs incurred and expensed before the cost reporting

[8] The parties use the term "goodwill" to denote the excess of the sale price of the facilities over the fair market value of the land, buildings, and equipment involved in the sale. *Cf. Richard S. Miller & Sons, Inc. v. United States,* 210 Ct. Cl. 431, 437, 537 F.2d 446, 450 (1976) (goodwill can be used to denote all the intangible assets of a business).

periods in issue.[9] The fiscal intermediary disallowed them *in toto* on the ground that they had not been included in the providers' records during the cost periods involved or capitalized as required under a Medicare regulation (HIM–15, § 2132.2). The Hearing Panel held that, though the costs had been expensed, for Medicare purposes they were deferred until the preparation of the cost reports. The Hamilton and Nutmeg Pavilions had been in the Medicare Program approximately one year each. Because HIM–15, § 2132.3B, *supra,* allowed the amortization of start-up costs over a period of 36 months, plaintiffs were allowed 33–1/3% of those costs as a reimbursable expense. The Panel found, however, no goodwill involved in the sale of the facilities and noted that none was carried on the books of either the buyer or the seller. We agree with the defendant that the Panel's treatment of the start-up costs cannot be deemed unfair or inequitable, and in the circumstances there was no violation of the Constitution or any statute or regulation having the force of law. *Cf. Overlook Nursing Home, Inc., supra,* 214 Ct. Cl. at 71, 556 F.2d at 505 (plaintiff entitled to portion of start-up costs amortizable during period of participation in Medicare Program). Similarly, the determination that there was no goodwill involved in the sale was scarcely arbitrary in view of the fact that little evidence was presented which would have allowed any sound determination of the existence or fair market value of such goodwill.[10] As it was, there are substantial indications that the facilities had been losing money and that any figure for goodwill would have been most speculative.[11]

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[9] The plaintiffs had originally attempted to claim the start-up costs as an allowable cost during the cost reporting periods in question.

[10] In another Medicare provider case, *Belmore Manor, Inc. v. Califano,* No. C 76–909 (N.D. Ohio, filed Oct. 31, 1977), the court approved the decision of the Provider Reimbursement Review Board and stated:

"In an instance where plaintiff and previous owner have evinced no clear intention of bargained for goodwill as part of the purchase price, and where all parties to the transaction made no effort to make clear to those not privy to the transaction of the elements of the sale, this Court will not mandate that an intermediary guess the parties' intention and infer an element of goodwill on which the intermediary would then need to place an arbitrary value." [*Belmore Manor, Inc. supra,* slip op. at 1.]

[11] A dissenting Hearing Panel member thought there had to be goodwill because the assets and the stock appeared to him to have been overstated by the parties to

III

A. The next issue is the disallowance of certain costs incurred by the plaintiffs in connection with advertising by radio, TV, and other media and with public relations activities of a promotional nature, all intended to increase the general occupancy of the facilities. The Hearing Panel held that, though the costs may have been reasonable and prudent, they could not be considered reimbursable because they were not directly related to Medicare patient care. The Panel sustained the intermediary's disallowance of the costs on the basis of the general provisions in 20 C.F.R. § 405.451(a) (1970) and the specific provisions of Provider Reimbursement Manual HIM–15 § 2136.2; the latter expressly disallows the costs of advertising directed to the general public for the purpose of increasing the utilization of the provider's facilities. Plaintiffs say that they were uninformed of any administrative guidelines in regard to such advertising costs until after the cost periods in question when they received a letter in February 1970. They challenge the application to them of the specific provision of the Provider Reimbursement Manual.

First, claimants characterize these advertising expenditures as "indirect expenditures related to lowering the per diem cost of care of the beneficiaries," and therefore necessarily allowable under the Medicare statute (42 U.S.C. § 1395x(v)(1) (1970)) and the general Medicare regulation covering reimbursable costs (20 C.F.R. § 405.451 (1970).[12]

the sale agreement. We think, however, that the Panel was not compelled to go behind the sales contract the plaintiffs had themselves voluntarily made, in order to revalue the stock and assets.

[12] 42 U.S.C. § 1395x(v)(1) (1970) before amendment in 1972, read in pertinent part:

"The reasonable cost of any services shall be determined in accordance with regulations establishing the method or methods to be used . . . . Such regulations shall (A) take into account both direct and indirect costs of providers of services in order that, under the methods of determining costs, the costs with respect to individuals covered by the insurance programs established by this subchapter will not be borne by individuals not so covered, and the costs with respect to individuals not so covered will not be borne by such insurance programs, and (B) provide for the making of suitable retroactive corrective adjustments where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive." 20 C.F.R. § 405.451 (1970) provides in pertinent part that:

"(a) *Principle.* All payments to providers of services must be based on the "reasonable cost" of services covered under title XVIII of the Act and related to the

To us, however, it is not unreasonable to read both the Act and the general regulation—each pointing directly to the costs incurred in serving Medicare patients—as precluding reimbursement of such indirect expenditures only tangentially or speculatively related to the actual care of Medicare beneficiaries. It follows that the specific rule of the Provider Reimbursement Manual (HIM–15 § 2136, *supra*) is inconsistent with neither the statute nor the overriding regulation.[13]

Plaintiffs then contend that HIM–15 § 2136 is a substantive rule not promulgated in accordance with the Administrative Procedure Act, 5 U.S.C. § 553 (1970), which requires notice of the proposed rule in the Federal Register with an opportunity to interested members of the public to comment. 5 U.S.C. § 553(b),(c) (1970). There is, however, an exception under 5 U.S.C. § 553(b)(A) (1970) for "interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice." The question is whether this provision of the Reimbursement Manual is a substantive or an interpretative rule.

To solve this problem we need not go exhaustively into all the general criteria for distinguishing one type from another. *See Gibson Wine Co. v. Snyder*, 194 F.2d 329, 331 (D.C. Cir. 1952); *New Jersey Chapter Incorporated of the American Physical Therapy Assoc. v. Prudential Life Ins. Co. of America*, 502 F.2d 500, 505 (D.C. Cir. 1974), *cert. denied*, 420 U.S. 1004 (1975); *Continental Oil Co. v. Burns*, 317 F. Supp. 194, 197 (D. Del. 1970); *Pharmaceutical Manufacturers Assoc. v. Finch*, 307 F. Supp. 858 (D. Del. 1970); *Pennsylvania v. United States*, 361 F. Supp. 208

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care of beneficiaries. Reasonable cost includes all necessary and proper costs incurred in rendering the services, subject to principles relating to specific items of revenue and cost.

. . . .

"(c)(3) The determination of reasonable cost of services must be based on cost related to the care of beneficiaries of title XVIII of the Act . . . . However, where the provider's operating costs include amounts not related to patient care, or specifically not reimbursable under the program, such amounts will not be allowable."

[13] In *Moody Nursing Home, Inc. v. Secretary of HEW*, No. 75–72 A, slip op. at 20 (N.D. Ga., Jan. 10, 1977), *vacated* and transferred to Court of Claims, 578 F.2d 1158 (5th Cir. 1978), the court approved the disallowance of such advertising costs on the ground that reimbursable costs had to be necessary to the efficient delivery of covered services and related to the health care of the beneficiaries.

(M.D. Pa.), *aff'd mem.*, 414 U.S. 1017 (1973); *American Assoc. of Councils of Medical Staffs of Private Hospitals, Inc. v. Mathews*, 421 F. Supp. 848 (E.D. La. 1976); *Saint Francis Memorial Hospital v. Weinberger*, 413 F. Supp. 323 (N.D. Cal. 1976); K. DAVIS, ADMINISTRATIVE LAW TEXT 126–31, 135 (3d ed. 1972). All agree that an interpretative rule merely clarifies or explains existing law or regulations. Here, it is enough that the preexisting general regulation (20 C.F.R. § 405.451, *supra*) could easily and reasonably be understood as, in itself, forbidding reimbursement of the claimed advertising expenses. It was, in short, helpful to issue HIM–15 § 2136, but not essential. *Cf. New Jersey Chapter Inc. etc. v. Prudential Life Ins. Co., supra*, 502 F.2d at 504–05.

This was how the Government viewed the specific provision. The transmittal letter for the issuance of HIM–15 § 2136 noted:

> *Section 2136ff., Advertising Costs,* provide[s] instructions on the treatment of provider-incurred advertising . . . costs. The instructions do not reflect new policy but expand on the existing program position on these costs. Regulation § 405.451 specifies that all payments to providers must be based on the reasonable cost of such services covered under title XVIII and related to the care of beneficiaries. This yardstick of measuring reasonable cost must necessarily apply to the allowability of advertising and membership costs. [emphasis added]

Naturally, the characterization applied by the agency does not control. *Columbia Broadcasting System, Inc. v. United States*, 316 U.S. 407, 416 (1942); *Pharmaceutical Manufacturers Assn., supra*, 307 F. Supp. at 863. But, as we have said, it is clear to us that the new rule effected no change in policy or in law; it explained what the more general terms of the statute and the regulation could already be deemed to require. *Gibson Wine Co., supra.*

The Medicare-provider court decisions which have called certain rules substantive, rather than interpretative, are quite different. In *St. Elizabeth Hospital v. United States, supra*, 214 Ct. Cl. 322, 327–31, 558 F.2d 8, 12–14 (1977), the challenged Manual provision altered a prior 10-year period for effecting a change in depreciation to a drastically shorter 2-year period. In *St. Francis Memorial Hospital v.*

Weinberger, 413 F. Supp. 323 (N.D. Cal. 1976), *now on appeal,* the pre-existing regulation was held to permit a provider either to expense or to capitalize construction costs while the later Manual provision required that these costs be capitalized. Similarly, in *Rio Hondo Memorial Hospital v. Weinberger* (C.D. Cal. 1975), 3 CCH Medicare and Medicaid Guide ¶ 27,508, *now on appeal*—the provision held substantive by the court declared that, when a facility is sold to a related party, the buyer's depreciation basis cannot exceed the seller's—the court seemed to believe that the Manual sharply changed a pre-existing rule.

Finally, claimants say that in any event retroactive application of HIM–15 § 2136 to a prior fiscal period denies them due process. What we have already said disposes of that contention. While retroactivity which denies an antecedent right may be improper, retroactivity without such effect is lawful. *See Thorpe v. Housing Authority,* 393 U.S. 268, 281–82 (1969); *Coe v. Secretary of H.E.W.,* 502 F.2d 1337, 1339–40 (4th Cir. 1974). Here, as we have stressed, there was no deprivation of a preexisting right given either by statute or by regulation. Nothing was taken away from plaintiffs by the specific provision of the Provider Reimbursement Manual.

B. Defendant contests that part of the Hearing Panel's decision which held that, since the disallowed advertising costs were incurred to stimulate the occupancy rate of the facilities in order to meet a condition of the sales agreement, the sale price of the facilities should be reduced by the amount of the disallowed advertising costs. The defendant notes that the sale agreement was executed on June 25, 1968, and Abbet Manor and Danbury Pavilion were transferred almost immediately thereafter on June 27, 1968. We are told that the advertising costs could not have been incurred to meet any sale condition in regard to these two facilities. The plaintiffs respond that the costs were incurred during the negotiations leading up to the agreement. From the facts, it would appear that those two facilities had been completed as of the time of the execution of the agreement, while the others had yet to be finished. The contract called for the closing on the uncompleted facilities when they had at least 60 patients.

Given the occupancy requirement for the incomplete facilities, it is reasonable to assume that the plaintiffs also had to build up the business in their completed facilities during the course of negotiations leading to a package sale of a number of similar facilities. We find nothing arbitrary or capricious in the Hearing Panel's reduction of the sale price by the advertising costs and therefore affirm that decision.[14]

IV

There is also a controversy over the treatment of unamortized deferred financing charges, incurred in acquiring mortgage financing. Plaintiffs urge that they should be allowed the unamortized balance of the deferred financing charges as a reimbursable cost in the accounting periods in which the transfers of the facilities occurred. The fiscal intermediary permitted only the amounts amortized during the cost periods in question and offset the unamortized balance against the sale price of the facilities. The Hearing Panel affirmed the actions of the intermediary on the basis of HIM–15 § 204, which requires that such costs be amortized over the life of the mortgage and states that the portion pertaining to the particular reporting period is an allowable cost. The providers rely on the testimony of their comptroller that their treatment is a generally accepted accounting procedure, and again argue that a substantive rule not promulgated in accordance with the Administrative Procedure Act is being applied retroactively.

Where there are several acceptable accounting methods, the judgment of the Department of Health, Education and Welfare as to which method most appropriately implements the principles of reimbursement under the Medicare Program is entitled to deference. HIM–15 § 204 does accord

[14] Since we hold that the Hearing Panel did not act arbitrarily or capriciously in its determination that the advertising costs were incurred in connection with the sale of the facilities, we do not reach the question of whether this court has jurisdiction over a claim by the defendant for set-off or recovery in Medicare provider cases. *Cf. S&E Contractors, Inc. v. United States*, 406 U.S. 1 (1972); *Roscoe-Ajax Constr. Co. v. United States*, 204 Ct. Cl. 726, 499 F.2d 639 (1974) (restrictions on the right of the Government to make claims in Government contract cases).

with one generally accepted accounting procedure.[15] Moreover, under Medicare only costs properly attributable to the care of beneficiaries of the program are reimbursable. 42 U.S.C. § 1395x(v)(1)(A) (1970); 20 C.F.R. § 405.451 (1970). Carrying out this principle, HIM–15 § 204 gives reimbursability only to those portions of the deferred financing charges which are properly attributable to the time of Program participation. Since the cost of securing mortgage financing is ascribable to the entire life of the mortgage, HIM–15 § 204 is plainly consistent with the general reimbursement principles of the Program.[16]

With regard to the plaintiffs' invocation of the Administrative Procedure Act, what we have said in connection with the disallowance of advertising costs (Part III *supra*) is equally applicable here. HIM–15 § 204 is interpretative, not substantive. No special procedure had to be followed in adopting it. And since it makes no change in the preexisting law, the issue of unjustified retroactivity does not arise. *See* K. DAVIS, ADMINISTRATIVE LAW TEXT 135 (3d ed. 1972). In addition, plaintiffs are hardly in a position to complain. Their practice was to amortize their deferred financing costs; they had not previously expensed them. Accordingly, no new method of accounting was imposed upon them differing from their prior practice. *Contrast Saint Francis Memorial Hospital, supra*, 413 F. Supp. 323; *Columbia Heights Nursing Home and Hospital, Inc. v. Weinberger*, 380 F. Supp. 1066, 1072 (M.D. La. 1974) (court noted that it would be "grossly unfair, terribly unjust" to allow a fiscal intermediary to apply retroactively to the provider a new method of cost allocation, when the provider had followed a system previously established by the fiscal intermediary).

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[15] *See* Accounting Principles Board Opinion No. 12, ¶¶ 16–17.

[16] It is important to note that different goals may in some instances be involved in principles of reimbursement under the Medicare Program as contrasted to accounting for the purposes of measuring income. The cardinal standard of Medicare reimbursement is that the Program covers only those costs relating to the health care of covered individuals and not the costs of individuals not covered. 42 U.S.C. § 1395x(v)(1) (1970); *Mount Sinai Hospital of Greater Miami, Inc. v. Weinberger*, 517 F.2d 329, 335 (5th Cir. 1975), *cert. denied*, 425 U.S. 935 (1976); *Moody Nursing Home, supra*, No. 75–72 A, slip op. at 25.

V

The last issue involves certain interest-free loans entered on the books of some of the providers, which had been made to related enterprises of plaintiff Gosman, before the providers began their participation in the Medicare Program. As a result of these loans, the fiscal intermediary determined that certain interest expense incurred by the providers could not be allowed under 20 C.F.R. § 405.419(b)(2) (1970), which permits, as a reimbursable expense, only interest on loans necessary to satisfy the financial need of the provider and related to patient care. The intermediary took the position that the sums lent to the related enterprises could have been used to pay back the loans and reduce the need for mortgage financing. The intermediary also refused to allow the sums lent to be included in equity capital on the basis of HIM–15 Ch. 18, which authorizes a return on equity capital only to the extent that the funds are related to providing patient care. The Hearing Panel approved these actions.

The plaintiffs contend that the loans were really Gosman's personal ones appearing on the books of the providers because of "poor bookkeeping practices," and that the determinations of the Hearing Panel were contrary to 20 C.F.R. § 405.402(a),(b)(4), which claimants take as excusing this bookkeeping mistake.[17]

The Panel was obviously not compelled to accept Gosman's testimony that the loans were technically "personal,"[18] but even if that be taken as proved *arguendo* we could not upset the determination. Gosman operated a number of nursing homes and related facilities as his own, and the Panel could allowably infer, in the absence of evidence to the contrary, that if he felt able to withhold the

[17] 20 C.F.R. § 405.402 provides in pertinent part:

"(a) In formulating methods for making fair and equitable reimbursement for services rendered beneficiaries of the program * * * [it shall be provided] * * *

"(b)(4) That there be sufficient flexibility in the methods of reimbursement to be used, particularly at the beginning of the program, to take account of the great differences in the present state of development of recordkeeping."

It is doubtful that this regulation, which refers to *methods* of accounting and cost allocation, was designed to condone slipshod bookkeeping which was bad under any general method of accounting and cost allocation.

[18] See note 17, *supra*.

funds in question from the providers now before us (on whose books the loans were recorded), and to use the money instead for others of his Medicare enterprises, some of the borrowings made by the providers involved in this case were not shown to be necessary for patient care in these specific facilities. The same is true for the exclusion of the sums lent as equity capital, which the statute (42 U.S.C. § 1395x(v)(1)(B)), the regulations (20 C.F.R. § 405.429) and the Providers Reimbursement Manual (HIM–15 § 1218) limit to amounts related to Medicare patient care. Sums invested outside of the providers now before us need not be deemed invested or related to the care of the Medicare beneficiaries in the particular facilities with which we are concerned in this case.

VI

In concluding, we emphasize that we find no more than that on the basis of the evidence before it, the actions of this Hearing Panel were not arbitrary, capricious, unsupported by substantial evidence, and were not inconsistent with the Constitution, applicable statutes, or regulations having the force of law. We therefore uphold the Panel's decision. The defendant's motion for summary judgment is granted except to the extent the defendant contests the decision of the Panel allowing the deduction of the advertising costs from the sale price of the facilities. The plaintiffs' motion for summary judgment is denied and the petitions will be dismissed. Since the Hearing Panel made no determinations with respect to quantum, the cases will be returned to the Panel for computations of the amounts due to the defendant, and to the plaintiffs.[19] The dismissal of the petitions is deferred pending these administrative proceedings, and further proceedings in this court are suspended under Rules 149–150 for a period of six months. The attorney for the defendant is designated to give the court the information required by Rule 149(f).

It is so ordered.

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[19] Neither party objects to return of the case to the Hearing Panel for this purpose, rather than determination by the Trial Division of this court.

572 F.2d 745

GENERAL ELECTRIC COMPANY v. THE UNITED STATES

[No. 81–70. Decided February 22, 1978]

ON THE PROOFS

Patents; infringement; patentability; obviousness; repair v. reconstruction.—Plaintiff contends that various claims of U.S. patents Nos. 2,414,685, 2,550,514 and 2,679,138 relating to servo-mechanisms have been used or made by or for defendant without license or lawful right. Plaintiff seeks reasonable and entire compensation for such unauthorized use. Defendant has raised numerous defenses. For reasons stated in the opinion, it is *held* that the claims at issue in the first two patents listed above are invalid, that claims 7 and 17 of patent 2,679,138 are invalid, and that while claim 8 of said patent is valid and reads on the accused device, defendant's overhaul operations at NOS Louisville were not a reconstruction, but a permissible non-compensatory repair. Accordingly, plaintiff is not entitled to recover in this suit and the petition is dismissed.

Patents; specification and claims; construing and interpreting; generally.

[1] Since the patentee is his own lexicographer, no genuine issue of fact as to the meaning of a claimed term can be found to exist where the meaning is made incontrovertibly clear elsewhere in the patent or in the file wrapper.

Patents ⚖168(1)

Patents; claims; construing and interpreting; comparison with other claims.

[2] Significant evidence of the scope of any claim is the language employed in other claims of the same patent.

Patents ⚖165(5)

Patents; claims; claims reciting "means".

[3] An element of a claim that is couched in terms of a means-plus-a-function statement, in compliance with 35 U.S.C. § 112, must be interpreted as including all disclosed elements necessary to perform the stated function.

Patents ⚖165(3)

Patents; claims; claims reciting "means".

[4] When a "means" term is employed in a claim, it is ordinary and customary to interpret that language as an attempt to use means-plus-a-function terminology as allowed by 35 U.S.C. § 112. However, words used in a patent cannot be given their ordinary and accustomed

Syllabus

meaning where it appears from the patent that the inventor has attached some different and/or specific meaning to them.

Patents ⊂⊃165(3)

Patents; specification and claims; construing and interpreting; definition of terms.

[5] Where the patentee has defined a term and the Patent and Trademark Office has accepted that definition as evidenced by the file wrapper, the same definition should be applied by the courts.

Patents ⊂⊃168(1)

Patents; claims; scope.

[6] All claim limitations must be considered in determining the scope and manner of operation of a claim.

Patents ⊂⊃165(1)

Patents; claims; operability.

[7] Where the combination as claimed is inoperative for its claimed purpose, the patentee has failed to distinctly claim the disclosed invention as required by the second paragraph of 35 U.S.C. § 112.

Patents ⊂⊃101(10)

Patents; claims; generally.

[8] A claim to be valid must recite a structure that is capable of performing the purported function.

Patents ⊂⊃101(1)

Patents; patentability; obviousness; generally.

[9] Claims defining inventions that would have been obvious to one of ordinary skill in the art at the time the inventions were developed are invalid.

Patents ⊂⊃18

Patents; claims; scope.

[10] The first necessary step in properly adjudicating the validity of patent claims is to establish their proper scope, since claims are the measure of the grant to the patentee. Patent claims are to be construed in light of the specification and both are to be read with a view to ascertaining the invention.

Patents ⊂⊃101(4,5)

Patents; specification; claims as part of disclosure.

[11] A percentage range that was part of the original claim language is part and parcel of the original disclosure.

Patents ⊂⊃104

Patents; specifications and claims; construing and interpreting.

[12] The phrase "a small residual" of power as used in the patent disclosure is relative and does not afford a basis for limiting the claims to a 100% figure of compensation, especially where it has not been adequately demonstrated that partial percentages of compensation do not likewise leave a small residual of power to be overcome by the control field.

Patents ⊂⊃104

Syllabus

Patents; specification and claims; construing and interpreting.

[13] An assignee in a patent infringement action cannot retreat to a narrower reading than that obviously urged during the prosecution of the patent by referring to the specification, especially when the specification does not expressly support the desired reading and the assignee is forced to rely upon vague implications from a few sentences in the specification.

Patents ⚖101(4)

Patents; claims; scope.

[14] In determining the true scope to be accorded claims of a patent, it is useful for the court to look to the inventors' subsequently filed related patent application for an understanding of what the inventors deemed of substantive importance in the earlier patent.

Patents ⚖168(1)

Patents; claims; limitations placed in claim.

[15] Claim limitations defining the subject matter of an invention can never be disregarded.

Patents ⚖165(2)

Patents; patentability; obviousness, tests of.

[16] Obviousness or nonobviousness of an invention is based upon a consideration of the relevant prior art, the differences between the claims in issue and that prior art, and the level of ordinary skill in the relevant technological art. *Graham* v. *John Deere Co.*, 383 U. S. 1 (1966).

Patents ⚖18

Patents; validity; presumption of validity.

[17] Pertinent references not considered during examination of a patent application seriously weaken the usual presumption of validity afforded all patents under 35 U.S.C. § 282.

Patents ⚖112.1

Patents; patentability; obviousness; generally.

[18] Whenever a 35 U.S.C. § 103 obviousness test is being applied, it is critical to the analysis to deliberately guard against using the teaching of the patent in suit in arriving at conclusions.

Patents ⚖18

Patents; equivalents, doctrine of; generally.

[19] The doctrine of equivalents is applicable where the patented and infringing devices operate in substantially the same way, perform substantially the same function, and produce substantially the same result.

Patents ⚖237

Patents; anticipation; generally.

[20] To anticipate a claimed invention, the prior art patents must show each and every element of the claim.

Patents ⚖66(1)

Syllabus

Patents; operability; generally.

[21] Where a claim recites and the specification describes an inoperative system, the claim is invalid.

Patents ⊂⇒30(1)

Patents; infringement; extent of right to use of patented device.

[22] Where the patent owner has not claimed that defendant is liable for use of the subject devices as originally procured and where the statute of limitations respecting any alleged infringement by such devices expired before defendant's overhaul operations, the manufacture and use of the original devices must be considered as licensed, thereby entitling defendant to *repair* them without paying further compensation.

Patents ⊂⇒255

Patents; claims; combination claims.

[23] A combination patent covers only the totality of the elements in the claim and no element separately viewed is within the grant; no element, not itself separately patented, that constitutes one of the elements of a combination patent is entitled to patent monopoly however essential it may be to the patented invention and no matter how costly or difficult replacement may be. *Aro Mfg. Co.* v. *Convertible Top Replacement Co.*, 365 U.S. 336 (1961).

Patents ⊂⇒177

Patents; infringement; repair v. reconstruction.

[24] Mere replacement of individual unpatented parts, one at a time, whether of the same part repeatedly or different parts successively, is no more than the lawful right of the owner to repair his property.

Patents ⊂⇒255

Patents; infringement; repair v. reconstruction.

[25] Where overhauled gun mounts were refurbished from components in the original mounts or defendant used components obtained only from plaintiff,—and thus plaintiff must be taken as the source of almost all of the elements making up both the original and the overhauled combination,—defendant was not creating a new article but its overhauling operations constituted lawful repair.

Patents ⊂⇒255

Patents; evidence; burden of proof; infringement.

[26] Plaintiff has the burden of proof on issues relating to infringement, including reconstruction, of the patented device.

Patents ⊂⇒312(1)

Patents; license; implied license to use.

[27] In paying the patent owner for the original gun mounts or, in the overhaul process, using only components purchased from the patent owner, defendant impliedly obtained a license to use the claimed combination, and compensated the patent owner therefor.

Patents ⊂⇒210

Patents; infringement; extent of right to use of patented device.

[28] As part of the bargain of sale, the seller of a device incorporating a patented combination composed of unpatented elements authorizes the buyer to continue to use the device so long as the latter can and does use the elements he purchased from the patent owner.

Patents ⟸211(1)

Patents; infringement; replacement of components v. reconstruction.

[29] Replacement of one or two elements of a many-elemented combination does not constitute reconstruction by a licensed user.

Patents ⟸255

Patents; infringement; repair v. reconstruction.

[30] Reconstruction of a patented device is not shown where, instead of disassembling and refurbishing the gun mounts individually one-by-one, defendant achieved the same result using an assembly-line method which was a speedier, less expensive, more efficient, and more effective means.

Patents ⟸255

Douglas B. Henderson, attorney of record, for plaintiff. *Finnegan, Henderson, Farabow & Garrett, Richard H. Smith, C. Larry O'Rourke, Irving M. Freedman, Harry F. Manbeck, Jr.,* of counsel.

Steven Kreiss, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before COWEN, *Senior Judge,* DAVIS, KASHIWA, KUNZIG and BENNETT, *Judges, en banc.*

PER CURIAM: This patent suit concerning servomechanisms presents several separate issues. Trial Judge Colaianni has filed a thorough and careful report giving his rulings and finding the relevant facts. Plaintiff has sought review of significant parts (but not of all) of the adverse aspects of the trial judge's decision, and the defendant asks review of all the decision adverse to it. We have heard oral argument *en banc* and considered the briefs and record. Our conclusion is that the trial judge is correct on all points except his ruling that defendant's overhaul of the 5"/38 single Mk 30 gun mounts at NOS Louisville during the 1967 to 1971 period amounted to impermissible reconstruction for which plaintiff should be compensated. We hold, on the contrary, that such overhaul

amounted to permissible non-compensatory repair. On that issue we do not adopt the trial judge's opinion but set forth our own differing views in Part II, *infra*, of this *per curiam* opinion. In Part I, *infra*, we adopt as our own, and set forth, the trial judge's opinion on the other aspects of the case (with minor supplementation and modification by the court).* Our ultimate conclusion is that plaintiff is not entitled to recover and the petition is dismissed.

PART I.

Trial Judge Colaianni's opinion (except for the part dealing with overhaul at NOS Louisville, and also including minor supplementation and modification by the court) is as follows:

COLAIANNI, *Trial Judge:* In this patent suit under 28 U.S.C. § 1498, plaintiff contends that various claims of three of its patents have been used or made by or for defendant without license or lawful right. Plaintiff, accordingly, seeks reasonable and entire compensation for such unauthorized acts. Defendant pleaded a whole host of defenses. Indeed, the validity of each of the patents is attacked on a variety of grounds. In addition, defendant alleges that it does not infringe any of the patents at bar.

Plaintiff is the owner by assignment of the entire right, title and interest in the patents here in suit. The parties have agreed to the deferral of the issue of accounting until after final resolution of the question of liability.

For reasons hereinafter stated, it is concluded that the claims at issue in United States Letters Patents 2,550,514 and 2,414,685 are invalid. It is further concluded that claims 7 and 17 of United States Letters Patent No. 2,679,138 are invalid. It is also concluded that claim 8 of patent No. 2,679,138 is valid.

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* While the court adopts (with some modifications and additions) the trial judge's separate findings of fact, as set forth in his report filed September 16, 1976, they are not printed herein since they are voluminous and the facts necessary to understand the decision are contained in this *per curiam* opinion.

Patent No. 2,550,514

United States Letters Patent No. 2,550,514 (hereinafter referred to as the '514 patent) was issued to Dr. Ernst F.W. Alexanderson on April 24, 1951, for an invention entitled "System for Reproducing Position" and was based on an application filed on May 19, 1932.

The invention relates to position follow-up control systems or servomechanisms. Generally, such systems are characterized by a pilot device and a driven object. An objective is to have the driven object follow the positional movement of the pilot device accurately and in a stable manner. An example of such a system is a shipborne gun and turret which is driven to follow the position of a telescope.

Conventionally, well-known induction devices, commonly referred to as selsyns, are connected between the telescope and gun such that a voltage signal is generated which is representative of the positional departure of the gun from the telescope. Amplifiers are used to amplify the voltage or error signal for actuation of a direct current (hereinafter sometimes referred to as "d.c.") motor which in turn controls the movement of the gun towards correspondence with the telescope. As the gun approaches positional agreement with the telescope, the error signal is proportionally reduced, eventually reaching zero when correspondence is achieved. Basic position control systems such as that described above were known prior to the invention of the '514 patent.

Positional servomechanisms of the above kind encounter problems of oscillation, commonly known as hunting, due to the inertia of the objects involved and the inherent time lags due to the servo components. Hunting can basically be described as oscillation of the gun back and forth about the point of correspondence. Due to the inductance of the servo components, the error signal is constantly lagging the actual departure of the gun from correspondence. As a result, the corrective action also lags the actual departure at any given moment, thus causing the gun to continually overshoot the desired position. Such a phenomena is clearly

undesirable in many systems where speed and accuracy of position are critical.

Traditionally, one approach to servo control involved increasing the system gain in an effort to eliminate hunting. The gain of a system is defined as the ratio of output power, current or voltage, to input power, current or voltage, respectively. Such an approach is unsatisfactory, however, since instability is encountered once a certain gain level is reached. Thus, there is a trade-off in any servo system between gain and stability. The prior art of record in this action discloses various techniques of position control aimed at eliminating or preventing the problem of hunting.

Plaintiff's Patented System

The invention of the '514 patent is drawn to a position control system of the above variety wherein hunting is eliminated or prevented.

At col. 2, lines 28 to 38, of the '514 patent, Dr. Alexanderson broadly describes one approach to anti-hunting:

> In carrying the invention into effect in one form thereof, changes in the torque or synchronizing force are utilized for modifying the synchronizing force in such a manner as to anticipate the final position and to bring the interconnected devices into correspondence without hunting or oscillation. In a system in which an electric motor is employed to drive an object into positional agreement with a control object, changes in the torque of the motor are so utilized.

Figure 1 of the '514 patent, reproduced in the findings, synthesizes this concept.

In the patented system a pair of selsyns are connected between a gun and telescope for generating a voltage representative of the error or positional disagreement. This error signal is applied to a thyratron control amplifier and, following amplification, is supplied to a direct current motor for driving the gun into correspondence with the telescope.

In order to avoid hunting by the gun, circuitry is provided for generating a modifying signal that combines

with the error signal applied to the thyratron amplifier for driving the direct current motor. As disclosed, the circuit includes an anti-hunting means, described as being composed of a magnetic saturable core reactor having a plurality of direct current-supplied control windings and a plurality of alternating current-supplied reactive windings which are inductively related to each other. The control windings are connected in series to form a bridge and the reactive windings are connected in parallel to form a bridge.

One diagonal of the reactive winding bridge is connected to a source of alternating current while the other diagonal is connected to the control windings of an output transformer, which applies the bridge output to the control circuit of the thyratron amplifier. One diagonal of the control winding bridge is connected to a source of direct current while the other diagonal is connected to the secondary winding of an input transformer. The manner of operation of the input transformer will be described in greater detail, *infra*, but generally can be described as permitting only changes of torque of the d.c. motor to initiate operation of the anti-hunting means.

The primary winding of the input transformer is shunted by an unmarked resistor and connected across the armature of the direct current drive motor. No voltage is induced in the secondary winding of the input transformer when the drive motor current is steady. However, when the drive motor current is changing, a voltage is induced in the transformer secondary and applied to the anti-hunting means. In the absence of an input, the anti-hunting means is magnetically balanced. Any input unbalances the bridge, causing a proportionate output to be applied by way of the output transformer to the thyratron control amplifier. In turn, the operation of the amplifier will affect the direct current motor.

The patent clearly teaches that no modifying signal is to be produced during constant current operation of the direct current drive motor. The self-imposed limitation of the anti-hunting operation by the patentee to only such times when the torque of the direct current drive motor is

changing is emphasized at col. 8, line 61, to col. 9, line 3, of the '514 specification:

> Thus it will be seen that a change in the direction of rotation of the motor * * * [12] produces a change or a reversal of the phase of the voltage supplied from the anti-hunting device to the control circuit of the electric valve apparatus. Furthermore, it will be observed that since the direct current control winding bridge is connected to the motor circuit through a transformer that the anti-hunting means 55 is responsive only to changes in the motor current and since the voltage which it supplies to the control circuit for the electric valve apparatus is roughly proportional to the motor current, the anti-hunting means 55 is in this sense responsive to the rate of change of motor current and since the motor current is a measure of its torque, the anti-hunting means is thus responsive to rate of change of torque.

A further characteristic of the anti-hunting means is that it causes the modifying signal to lag changes in the drive motor current, as described in the specification at col. 12, lines 23 to 30:

> Due to the fact that the alternating current reactive coils of each arm of the bridge are short circuited upon each other, the anti-hunting means functions as a transformer with a short-circuited secondary, the large inductance of which causes the direct current magnetization to be considerably lagging with respect to the changes in motor current.

However, the modifying signal applied by way of the output transformer to the thyratron amplifier causes the drive motor current to lead the actual departure from correspondence and operates to bring the gun into correspondence without overshoot.

Scope of Claims Involved in Suit

Plaintiff argues that the inventions defined by claims 35 and 36 of the '514 patent have been used and/or manufactured by defendant without plaintiff's authorization. Claim 35, broken down into lettered sections element by element for ease of reference, reads as follows:

35. A follow-up control system comprising in combination

(a) a pilot device,
(b) a driven object,
(c) driving means for said object,
(d) control means for said driving means,
(e) means responsive to positional disagreement of said pilot device and driven object for actuating said control means to control said driving means to drive said object toward correspondence with said pilot device, and
(f) anti-hunting means responsive to the rate of change of torque of said driving means for actuating said control means.

Claim 36, similarly broken down into lettered sections element by element, reads as follows:

36. A follow-up control system comprising in combination

(a) a pilot device,
(b) a driven object,
(c) driving means for said object,
(d) means for controlling the energization of said driving means,
(e) means responsive to positional disagreement of said pilot device and driven object for actuating said control means to control said driving means to produce a torque for driving said object toward correspondence with said pilot device, and
(f) anti-hunting means for actuating said control means in accordance with the rate of change of said torque.

Both claims 35 and 36 are combination claims drawn to position follow-up control systems.

Defendant asserts that both claims 35 and 36 are invalid under 35 U.S.C. § 102 (1970 & Supp. V 1975) and 35 U.S.C. § 112 (1970 & Supp. V 1975). Further, noninfringement is also asserted as a defense. In view of the conclusions reached with respect to Section 112, the court need not and does not reach the validity question under Section 102 or the infringement issue.

As a prelude to a thorough consideration of Section 112,[1] it is necessary to point out that the parties are in complete

[1] 35 U.S.C. § 112 provides in pertinent part: "The specification shall conclude with one or more claims particularly pointing out and distinctly claiming the subject

disagreement concerning the interpretation to be given element (f) of both claims 35 and 36. Defendant asserts that element (f) of claims 35 and 36 refers only to the anti-hunt means 55 shown in Fig. 1 of the '514 patent. On the other hand, plaintiff contends that anti-hunt means 55, input transformer 81 and its unmarked shunt resistance, as well as output transformer 75, are all included within the phrase anti-hunting means of both claims 35 and 36. As the following analysis will reveal, defendant's interpretation is the correct one.

In *Autogiro Co. of America v. United States*, 181 Ct. Cl. 55, 63, 384 F.2d 391, 397–98 (1967), this court, in referring to the relationship between the claims of a patent and its specification, stated:

> In serving its statutory purpose, the specification aids in ascertaining the scope and meaning of the language employed in the claims inasmuch as words must be used in the same way in both the claims and the specification. U.S. Pat. Off. Rule 75(d). The use of the specification as a concordance for the claims is accepted by almost every court, and is a basic concept of patent law. (footnotes omitted)

This precept takes on particular significance where the definition of a term appearing in a claim is disputed by the parties. Since the patentee is his own lexicographer, no genuine issue of fact as to the meaning of a claimed term can be found to exist where the meaning is made incontrovertibly clear elsewhere in the patent or in the file wrapper. *Duplan Corp. v. Deering Milliken, Inc.*, 370 F.Supp. 769, 772, 180 USPQ 373, 376 (D.S.C. 1973), and cases cited therein.

A careful review of the '514 patent and its file wrapper provides invaluable insight as to the proper interpretation and meaning to be given to element (f) of claims 35 and 36.

Turning first to the specification, col. 6, line 72, to col. 7, line 3, plaintiff emphasized that anti-hunting means 55 was to be responsive to transient conditions in the system:

> In order to prevent the gun 10 from hunting or oscillating about the position of correspondence with the telescope 11, *anti-hunting means* 55 are provided for

matter which the applicant regards as his invention."

> modifying or controlling the voltage applied to the control circuit of the electric valve apparatus 14 in accordance with transient conditions in the system. (emphasis added)

The structure referred to by the numeral 55 is subsequently referred to in the patent specification as the anti-hunting means 55, the anti-hunting device 55, or the anti-hunting detector 55, on numerous occasions. Significantly, there is not a single instance to which plaintiff can point where the specification refers to either transformer 81 or transformer 75 as the anti-hunting means. Equally significant is the lack of specification support for plaintiff's position that the phrase anti-hunting means was intended to cover transformers 75 and 81 as well as the bridge connected control and reactive windings.

A comparison of certain other claims of the '514 patent with claims 35 and 36 further supports the conclusion that the term anti-hunting means as used in the claims at bar refers only to anti-hunting means 55. Significant evidence of the scope of any claim is the language employed in other claims of the same patent. *Bethell v. Koch*, 427 F.2d 1372, 1374, 166 USPQ 199, 201 (CCPA 1970). *See also Stukenborg v. Teledyne, Inc.*, 299 F.Supp. 1152, 161 USPQ 10 (C.D. Calif. 1969), *aff'd*, 441 F.2d 1069, *cert. denied*, 404 U.S. 852 (1971); and *Leach v. Rockwood & Co.*, 273 F.Supp. 779, 154 USPQ 356 (W.D. Wis. 1967), *aff'd*, 404 F.2d 652 (1968).[1a]

Reference to claim 34 sheds particularly relevant light on the scope to be afforded claims 35 and 36. Claims 34, 35 and 36 were all introduced into the '514 patent simultaneously by an amendment during its pendency in the Patent and Trademark Office. Claim 34 reads as follows:

[1a] Plaintiff insists that the figure 55, being somewhat larger, was intended to include transformers 75 and 81, but the spacing and configuration on Figure 1 (of the patent) goes against that contention. Figure 55 seems clearly to include only the two bridges in the "anti-hunting square" (so described at col. 12, line 37, of the specification). Plaintiff also says that the paragraphs of the specification which describe transformers 75 and 81 are part of the description of the "anti-hunting means" 55 because they follow immediately upon the paragraphs referring to the "anti-hunting means." But we think that those subsequent paragraphs (which do not refer to "anti-hunting means") cannot fairly be read as an integral part of the disclosure of the "anti-hunting means"; rather they describe separate parts of the invention and seem to us to characterize transformers 75 and 81 as connecting devices outside of the "anti-hunting means." [footnote by the court].

34. A follow-up control system comprising in combination

(a) a pilot device,
(b) a driven object,
(c) driving means for said object,
(d) means responsive to positional disagreement of said pilot device and driven object for controlling said driving means to drive said object toward correspondence with said pilot device, and
(e) *means responsive to the rate of change of torque of said driving means for controlling said driving means to prevent hunting.* (emphasis added)

The last element of claim 34 is couched in terms of a means-plus-a-function statement. In compliance with 35 U.S.C. § 112,[2] this element must be interpreted as including all disclosed elements necessary to perform the stated function of preventing hunting. *See also Technitrol, Inc. v. Control Data Corp.*, 394 F.Supp. 511, 185 USPQ 801 (D. Md. 1975), *vacated on other grounds*, 550 F.2d 992 (4th Cir. 1977). By reference to the specification, it is clear that the claimed means includes input transformer 81 and its unmarked shunt resistance, anti-hunting means 55 and output transformer 75.

As a cursory comparison of claim 34 with both claims 35 and 36 reveals, this last element is one of the distinctions between the claims in issue and claim 34. Claim 34 also recites a single means clause for determining the error and controlling the object drive means whereas claims 35 and 36 recite both a positional disagreement determining means and a control means for the drive means. Otherwise, claims 34, 35 and 36 are basically identical in language.

To sustain plaintiff's position that element (f) of claims 35 and 36 structurally includes more than just anti-hunting means 55, would require the court to ignore the differences in language between the means to prevent hunting of claim 34 and the anti-hunting means of claims

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[2] The third paragraph of 35 U.S.C. § 112 (1970) (amended 1975) reads as follows:
"An element in a claim for a combination may be expressed as a means or step for performing a specified function without the recital of structure, material, or acts in support thereof, and such claim shall be construed to cover the corresponding structure, material, or acts described in the specification and equivalents thereof."

35 and 36. The difference in language exists and cannot be regarded as meaningless, especially when the patentee himself has repeatedly used the phrase anti-hunting means to refer only to structure 55 of the Fig. 1 embodiment. When a "means" term is employed in a claim, it is ordinary and customary to interpret that language as an attempt to use means-plus-a-function terminology as allowed by 35 U.S.C. § 112. However, words used in a patent cannot be given their ordinary and accustomed meaning where it appears from the patent that the inventor has attached some different and/or specific meaning to them. *Harrington Mfg. Co. v. White,* 323 F.Supp. 1345, 1353, 169 USPQ 193, 200 (N.D. Fla. 1971), *rev'd on other grounds,* 475 F.2d 788 (5th Cir.), *cert. denied,* 414 U.S. 1040 (1973).

Claim 2 of the '514 patent is also useful in establishing the meaning of terms used in, and the permissible scope of, coverage to be afforded to claims 35 and 36. That claim recites, *inter alia:*

> means responsive to changes in said current, and anti-hunting means controlled by said current change responsive means for modifying said alternating voltage and reducing the magnitude of said current in accordance with changes in said direct current as said devices approach correspondence.

A careful study of the claims in light of the '514 specification reveals that claim 2 especially recites and claims the transformer 81 and the anti-hunting means 55. Particularly, transformer 81 is characterized in claim 2 as "means responsive to changes in said current." Accordingly, it is abundantly clear that the phrase "anti-hunting means" was not intended to include transformer 81. Plaintiff's present argument that the phrase "anti-hunting means" is intended to cover transformer 81, anti-hunting means 55, and transformer 75 in claims 35 and 36 takes on a particularly hollow ring in view of the obvious intent that the phrase "anti-hunting means" covers something less than that combination of elements in claim 2. To be consistent with plaintiff's own use of terms in other claims of the same patent, it is essential in interpreting claims 35 and 36 that the term "anti-hunting means" be restricted to

the structure borne by the number 55 in Fig. 1 of the '514 patent and not include transformer 81.

In sum, it is concluded that element (f) of both claims 35 and 36 structurally cover no more than anti-hunting means 55 for to do otherwise would enable a patentee to define his invention in one way while seeking allowance of a patent from the Patent Office and in another way while seeking to have the patent enforced by the courts.

Where, as in the instant case, the patentee has defined a term and the Patent and Trademark Office has accepted that definition as evidenced by the file wrapper, the same definition should be applied by the courts. *Kaiser Industries Corp. v. McLouth Steel Corp.*, 400 F.2d 36, 49, 158 USPQ 565, 578 (6th Cir. 1968), *cert.denied*, 393 U.S. 1119.

Interpreting claims 35 and 36 in light of the above analysis dictates that anti-hunting means 55 be directly connected to the direct current drive motor 12. Moreover, in such a combination, since transformer 81 would not be present to block steady start motor currents, the anti-hunting means 55 would generate a modifying signal regardless of whether or not the drive motor current was changing or constant. In other words, anti-hunting means 55 would respond not only to changes of torque, but to all currents supplied to the direct current drive motor.

However, all claim limitations must be considered in determining the scope and manner of operation of a claim. As the following analysis will show, the limitations imposed in both claims 35 and 36 on anti-hunting means 55, *i.e.*, that it be responsive to or actuated in accordance with the rate of change of torque of the direct current drive motor, requires that a modifying signal not be generated under constant drive motor current conditions.

Turning again to the patent specification, it is necessary to reemphasize that col. 8, line 66, to col. 9, line 3, which was reproduced *supra*, during an earlier discussion of the '514 patent, clearly states that anti-hunting means 55 is responsive to the rate of change of the drive motor torque. From this it must be concluded that the patentee intended to limit the operation of anti-hunting means 55 to situations wherein the drive motor current was changing. That plaintiff intended the '514 invention to operate only

in response to changes in the drive motor current is further gleaned from a review of the prosecution history.

During the prosecution of the application upon which the '514 patent is based, original claim 5 was rejected as fully met by United States Patent No. 1,684,137 to Mittag, United States Patent No. 1,684,138 to Nixdorff, and French Patent 703,178 to Sperry. In response to the rejection, the claim was amended to provide anti-hunting means responsive "only to changes in said direct current." Counsel argued that the above change distinguished his invention over the references for the following reasons:

> In the Mittag patent the anti-hunting motor 63 is continuously responsive to the voltage of the driving motor 12 irrespectively of whether the voltage remains constant or changes. This is likewise true of the Nixdorff patent in which the coils 56–59 inclusive are connected across the field and armature terminals of the driving motor 12.
>
> Applicant's system in which the anti-hunting means respond only to changes in the current supplied to the driving motor 12 is believed to be superior to the systems disclosed in the Mittag and Nixdorff patents and since this feature is clearly specified in claim 5 as amended, it is accordingly believed that this claim will be found to be clearly allowable.

Apparently the patent examiner did not fully appreciate the meaning of plaintiff's remarks, however, for he continued the rejection and noted that it would require no invention to make the anti-hunt device either current or voltage responsive since in Nixdorff voltage and current are proportional once motor speed is established. Claim 5 was additionally rejected as fully met by United States Patent No. 1,811,860 to Morton which showed a current-responsive anti-hunting device.

In response, plaintiff again emphasized that the claim was drawn to anti-hunt means responsive only to changes in the motor current, thus excluding response to constant drive motor currents.

Patent claims 34, 35 and 36, submitted during examination as application claims 36, 37 and 38, were added to the application by amendment. In describing the subject matter of the claims, plaintiff noted that:

> As pointed out on page 15, lines 10–20 inclusive, applicant's anti-hunting system is responsive to the rate of change of torque of the driving means. *Each of the three added claims 36, 37, and 38 is limited to this specific feature.* (emphasis added)

Lines 10–20 of p. 15 of the application correspond to col. 8, line 66, to col. 9, line 3, of the issued patent, which describes the rate of change of torque in terms of the action of transformer 81.

The clear import of the '514 specification, as well as plaintiff's actions during prosecution of the application through the Patent and Trademark Office, dictate that element (f) of both claims 35 and 36 is structurally limited to anti-hunting means 55. It is equally clear that anti-hunting means 55 was intended to generate a modifying signal only during changing drive motor current conditions.

Claims 35 and 36 are Inoperative

Having concluded the anti-hunting means of claims 35 and 36 is a specific recitation of anti-hunting means 55, which responds only to changes in the direct current drive motor current, the conclusion is inescapable that both claims 35 and 36 fail to comply with 35 U.S.C. § 112 and are accordingly invalid.

Claims 35 and 36 fail to structurally recite, in any form, transformer 81. This element is an essential element of the combination for without transformer 81, or some equivalent means, the claimed combination is inoperative since there would be nothing to prevent the generation of a modifying signal by anti-hunting means 55 under constant current drive motor conditions. Since the combination as claimed is inoperative for its claimed purpose, the patentee has failed to distinctly claim the disclosed invention as required by the second paragraph of 35 U.S.C. § 112. *Wilson v. Midwest Folding Products Mfg. Co.*, 175 USPQ 649, 656 (N.D. Ill. 1972); *Shelco, Inc. v. Dow Chemical Co.*, 322 F.Supp. 485, 517, 168 USPQ 395, 415 (N.D. Ill. 1970), *aff'd*, 466 F.2d 613 (7th Cir.), *cert. denied*, 409 U.S. 876 (1972). Specifically, the anti-hunting means 55 cannot be

and is not responsive only to the rate of change of the drive torque absent some element, *i.e.*, transformer 81, for restricting the drive motor inputs thereto. A claim to be valid must recite a structure that is capable of performing its purported function. *Blohm & Voss AG v. Prudential-Grace Lines, Inc.*, 346 F.Supp. 1116, 1130, 174 USPQ 484, 496 (D. Md. 1972), *rev'd on other grounds*, 489 F.2d 231 (4th Cir. 1973), *cert. denied*, 419 U.S. 840 (1974). Accordingly, claims 35 and 36 are invalid.

*Patent No. 2,414,685**

United States Patent No. 2,414,685, hereinafter referred to as the '685 patent, was issued to Dr. E.F.W. Alexanderson, Dr. Martin A. Edwards and Mr. Kenneth K. Bowman on January 21, 1947, on an invention entitled "Follow-Up Control System."

The invention relates to position control systems for maintaining two objects in positional correspondence. Such systems generally comprise a pilot device, a driven object, selsyns, or similar devices for detecting the positional disagreement between the pilot and object, and structure for responding to the detected positional disagreement or error and moving the driven object into correspondence with the pilot.

The invention disclosed in the '685 patent relates to electrical servomechanisms for position control which utilize a compensated armature-excited dynamo-electric machine, described in detail hereinbelow, for supplying current to a d.c. drive motor for moving the driven object into correspondence with the pilot. The dynamo-electric machine is used as an alternative to conventional electronic tube amplifiers.

In one embodiment of the invention, high and low speed selsyn devices are connected between a pilot device and driven object for detecting and responding to the positional disagreement or mismatch therebetween. A Wheatstone bridge is suitably connected to the selsyn network such that a portion of the bridge is unbalanced in response to the direction and magnitude of the detected error. A

* Plaintiff does not seek review of the adverse holding of the trial judge with respect to Patent No. 2,414,685.

voltage is thus generated across the bridge which is impressed on the control field winding of a compensated armature-excited dynamo-electric machine.

The disclosed dynamo-electric machine is provided with a pair of load brushes arranged to commutate on a control or load axis and a pair of brushes arranged to commutate on a primary or short-circuit axis which is perpendicular to the control axis.

The brushes on the control axis are connected across the armature of a d.c. motor which drives the driven object. The brushes on the short-circuit axis are short-circuited by an appropriate winding.

The total flux on the control axis of the dynamo-electric machine is produced by the control field winding, the armature reaction of the current on the control axis, and a compensating field winding connected in series between the load brushes and the d.c. motor. The control axis flux gives rise to a voltage on the short-circuit axis which generates a short-circuit current.

The total flux on the short-circuit axis is produced by the armature reaction of the current on the short-circuit axis and a shunt field winding. The short-circuit axis flux produces a voltage across the control axis which gives rise to a load current for application to the d.c. motor.

Without the series compensating field winding on the control axis, the armature reaction flux of the load current, which opposes the control flux generated by the control field winding, would minimize the flow of current through the short-circuit path. However, since the flux generated by the compensating field winding is in line with the control flux, it opposes the armature reaction flux. In this manner, only a small residual of power input is required of the control field winding to generate an effective short-circuit current.

The result is that the control field winding turns can be reduced relative to conventional dynamo-electric machines. Moreover, the inductance of the machine is reduced, thus improving the machine's speed of response. A high-gain power output is also achieved.

The amplified output from the dynamo-electric machine is applied to the armature of the d.c. motor for driving the

object into positional correspondence accurately, quickly and in a stable manner.

A second disclosed embodiment of the '685 patent is quite similar to the system described above, with the exception that electronic tubes are substituted to perform the functions of the Wheatstone bridge arrangement.

The Issues

Plaintiff has alleged unauthorized manufacture and use by the defendant of the inventions defined by claims 7 and 11 of the '685 patent. In response, defendant has asserted the defenses of invalidity and noninfringement of the '685 patent, implied license to the inventions defined by the claims, failure to mark under 35 U.S.C. § 287 (1970), and, with respect to at least one of the accused devices, expiration of the statute of limitations. Since, as is explained more fully hereinbelow, it is concluded that the '685 patent is invalid, it is not necessary to address the remaining defenses asserted.

Defendant challenges the validity of claims 7 and 11 on the single statutory ground of obviousness, 35 U.S.C. § 103. For reasons which follow, it is concluded that the inventions defined by claims 7 and 11 of the '685 patent would have been obvious to one of ordinary skill in the art at the time the inventions were developed and are therefore invalid.

Scope of Claims 7 and 11 of the '685 Patent

The first necessary step in properly adjudicating the validity of patent claims is to establish their proper scope. It has long been recognized that the claims of a patent are the measure of the grant to the patentee. *See Strumskis v. United States*, 200 Ct.Cl. 668, 474 F.2d 623, *cert. denied*, 414 U.S. 1067 (1973). Nevertheless, the Supreme Court, in a series of cases stretching back to the early part of this century, has established that the claims of a patent are to be construed in light of the specification and both are to be read with a view to ascertaining the invention. *See*, e. g., *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243

U.S. 502, 510 (1917); *United States v. Adams*, 383 U.S. 39, 49, 148 USPQ 479, 482 (1966).

Indeed, this court, in *Autogiro Co. of America v. United States*, 181 Ct.Cl. at 61–2, 384 F.2d at 396–97, explained the necessity for interpreting claims in light of the specification:

> Claims cannot be clear and unambiguous on their face. A comparison must exist. The lucidity of a claim is determined in light of what ideas it is trying to convey. Only by knowing the idea, can one decide how much shadow encumbers the reality.
>
> The very nature of words would make a clear and unambiguous claim a rare occurrence.
>
> . . . The dictionary does not always keep abreast of the inventor. It cannot. Things are not made for the sake of words, but words for things.
>
> . . . .
>
> The necessity for a sensible and systematic approach to claim interpretation is axiomatic. The Alice-in-Wonderland view that something means whatever one chooses it to mean makes for enjoyable reading, but bad law. Claims are best construed in connection with the other parts of the patent instrument and with the circumstances surrounding the inception of the patent application.

Bearing these principles in mind, attention is focused on claims 7 and 11 of the '685 patent, whose elements appear below in lettered subsections for ease of analysis and reference:

7. In a follow-up control system having

(a) a pilot device and
(b) driven object, the combination with
(c) a direct-current electric motor for driving said object, of
(d) an armature excited dynamo-electric machine for supplying current to said motor, said machine having
(e) a control field winding,
(f) a pair of load brushes connected to said motor and arranged to commutate on said control axis,
(g) a pair of short-circuited brushes arranged to commutate on an axis at an angle with said control axis, and

(h) a series compensating field winding on said control axis having ampere turns equal to between 75 per cent and 125 per cent of the armature ampere turns, and
(i) means responsive to positional disagreement of said pilot device and driven object for supplying current to said control winding thereby to cause said motor to drive said object toward correspondence with said pilot device.

* * *

11. In a follow-up control system having

(a) a pilot device and
(b) driven object, the combination with
(c) a direct-current motor for driving said object, of
(d) an armature excited dynamo-electric machine having
(e) a control winding and
(f) a pair of load brushes arranged to commutate on the axis of said winding and connected to supply current to said motor,
(g) a pair of short-circuited brushes arranged to commutate on an axis at an angle with said control axis and
(h) a series field winding for compensating armature reaction on said control axis,
(i) electric valve apparatus for supplying a control current to said control winding, and
(j) means responsive to positional disagreement of said pilot device and driven object for controlling said valve apparatus to supply current to said control winding of a polarity depending upon the relative positions of said device and object thereby to cause said motor to drive said object toward correspondence with said pilot device.

On its face, claim 7 is directed to a follow-up position control system comprising the combination of a pilot device and a driven object, a d.c. motor for driving the object, an armature-excited dynamo-electric machine equipped with a series compensating winding whose ampere turns range from 75 to 125% of the armature ampere turns for supplying current to the d.c. motor and means responsive to the positional error between the pilot and object for supplying current to the control winding of the dynamo-electric machine for elimination of the positional error. Claim 7 contains the only recitation of the percentage

compensation afforded by the series field winding to be found anywhere in the '685 patent.

Similarly, claim 11 is directed to a follow-up position control system comprising the combination of a pilot device and driven object, a d.c. motor for driving the object, a compensated armature-excited dynamo-electric machine for supplying current to the d.c. motor, electric valve apparatus for supplying current to the control winding of the dynamo-electric machine and means responsive to the positional error between the pilot and object for control of the electric valve apparatus to eliminate the positional error. The dynamo-electric machine of claim 11 does not require any particular degree of compensation on the control axis but only broadly calls for "a series field winding for compensating armature reaction * * *."

Plaintiff urges that claims 7 and 11 are narrower in scope than their plain language suggests. Specifically, the threshold question to be decided is whether claims 7 and 11 are drawn to a follow-up position control system utilizing an armature-excited dynamo-electric machine for current supply having full or 100% compensation on its control axis. Stated differently, the issue is whether claims 7 and 11 only cover an armature-excited machine with a series compensation winding whose ampere turns are equal to 100% or more of the armature ampere turns, or are broad enough to cover an armature-excited machine with a series compensating winding whose ampere turns are less than the ampere turns of the armature.

This court has, to be sure, had occasion to apply a narrower interpretation to claims, when read in light of the specification, than the claim language would otherwise seem to require. *See Roberts Dairy Co. v. United States*, 208 Ct. Cl. 830, 530 F.2d 1342(1976). However, having carefully reviewed the '685 patent and its file history, as well as the contentions of plaintiff, it is concluded that claims 7 and 11 cannot properly be construed as limited exclusively to follow-up position control systems utilizing an amplidyne, *i.e.*, an armature-excited dynamo-electric machine with 100% or more compensation.

The series compensating field winding is described in the '685 patent specification at col. 3, lines 42–8:

> The series compensating field is used principally to reduce the control power. It is connected so that the series field ampere turns oppose the armature reaction turns along the control axis and leave only a small residual to be overcome by the control field. In this way the power amplification is increased many times.

The performance of the disclosed dynamo-electric machine is discussed at col. 4, lines 7 to 13, of the '685 specification:

> The predominant characteristics of machine 14 are rapid response, and low ratio of control watts to load watts, *e.g.* an amplification as high as 25,000:1.

No percentages of compensation are disclosed, although the 75 to 125% figure of claim 7 was part of the original claim language and thus is part and parcel of the original disclosure. *Bocciarelli v. Huffman*, 232 F.2d 647, 109 USPQ 385 (CCPA 1956). Nevertheless, this range of compensation, even when read into the '685 specification, cannot be concluded to be any more than exemplary or preferred. There is no indication in any part of the '685 patent which would justify treating the 75 to 125% limitation as exclusive or critical.

Plaintiff urges, through its expert witness Dr. Chestnut, that the phrase "having ampere turns equal to between 75 per cent and 125 per cent of the armature ampere turns," which appears in claim 7, is a technician's manner of saying 100 $\pm$ 25% compensation. In other words, it is a compromise between the theorist who desires 100% compensation and the technician who realizes it is not always achievable.

Such an interpretation cannot be gleaned from the patent or its file history. Indeed, if anything, a contrary interpretation is demanded from the above-quoted excerpts from the patent in suit. Plaintiff has failed to suggest any persuasive reasons for interpreting the 75 to 125% limitation that appears in claim 7 in any manner other than that dictated by its clear language. Specifically, this phrase is concluded to recite a range of compensation from 75 to 125% and, accordingly, claim 7 broadly covers partial, as well as 100% or greater, compensation.

Plaintiff would have the court conclude that the disclosure of "an amplification as high as 25,000:1" is tantamount to stating that the dynamo-electric machine has 100% compensation on the control axis. Quite clearly, however, the prefatory language "as high as" dispels any notion that a specific percentage compensation is intended and suggests a degree of flexibility which results in a range of gains with a ceiling of 25,000:1.

Plaintiff also points to the disclosure that the series field winding leaves "only a small residual to be overcome by the control field" as indicating 100% compensation. The phrase "a small residual" is relative. It is impossible to base a conclusion limiting claims 7 and 11 to 100% compensation on the sole basis of such a relative term, especially since plaintiff has not adequately demonstrated that partial percentages of compensation do not likewise leave what might be termed a small residual of power to be overcome by the control field.

The patentees, through their own action during the prosecution of the application through the Patent Office, did not expressly limit the claims in suit to 100% series compensation. Moreover, of equal significance is the fact that the specification does not clearly disclose the intention of the patentees to require the use of a series compensating winding having ampere turns equal to those of the armature. Their assignee will not now be allowed to retreat to a narrower reading than that obviously urged during the prosecution of the patent by referring to the specification, especially when the specification does not expressly support the desired reading, and plaintiff is instead forced to rely upon an assortment of vague implications from the construction of a few sentences in the specification. *Mueller Brass Co. v. Reading Indus.*, 352 F.Supp. 1357, 1365, 176 USPQ 361, 367 (E.D. Pa. 1972), *aff'd*, 487 F.2d 1395, 180 USPQ 547 (3d Cir. 1973).

Additional relevant factors militate against limiting the scope of claims 7 and 11 to require 100% or greater compensation on the control axis.

To begin, it was established at trial that the amplidyne, a dynamo-electric machine which has 100% or greater compensation on the control axis, is characterized by a

variable current output which responds to changes in the load. This variable current characteristic is not present in dynamo-electric machines which have less than 100% compensation (partial compensation), and such machines instead produce a constant current output independent of the load. The output current of partially compensated machines can only be varied by changing the ampere windings on the control winding of the machine.

Project reports filed with the General Electric Co. patent department prior to the January 21, 1939, filing date of the '685 patent demonstrate that the patentees, at that time, were fully aware of the difference in current output characteristics between partially and fully compensated machines. Nevertheless, the '685 patent specification, while referring to the prior art problem of independent load voltage and current characteristics in dynamo-electric machines, does not contain any discussion of the load voltage and load current characteristics of the disclosed compensated machine. In other words, the variable current output characteristic of amplidynes is not mentioned or discussed in the patent claims, specification, or file history of the '685 patent.

Significantly, 5 months later, in an application entitled "Dynamoelectric Machine" which matured into United States Patent No. 2,227,992, hereinafter referred to as the '992 patent, on January 7, 1941, Drs. Alexanderson and Edwards disclosed fully a dynamo-electric machine having variable current output characteristics, high amplification ratio and fast response time. The series compensating field winding in the '992 patent was disclosed at p. 2, col. 2, lines 52–60, as—

> * * * arranged substantially to neutralize the magnetic back coupling of electric current in the secondary circuit of the armature with the primary armature circuit by substantially neutralizing the armature reaction flux along the secondary axis. This field exciting winding 29 is adapted to neutralize substantially the armature reaction 22 under all load conditions, * * *.

Thus, couched in terms of substantial neutralization of the control axis armature flux and variable current output characteristics, it is clear that the series field winding of

the '992 patent was disclosed as providing 100% compensation of the control axis armature reaction flux and was, in essence, a disclosure of the amplidyne.

As an aid in determining the true scope to be accorded claims 7 and 11 of the '685 patent, it is useful to look to the subsequently filed '992 patent to assist the court in understanding what it was that the inventors deemed of substantive importance in the earlier patent. *Jacwil Mfrs. v. Batesville Casket Co.*, 311 F.2d 38, 42, 136 USPQ 42, 45 (7th Cir. 1962), *cert. denied*, 372 U.S. 942 (1963).

Viewing the '685 disclosure in the context of all the factors discussed above, as well as what was disclosed in the '992 patent, it is concluded that the inventors' intent in the earlier '685 patent was to disclose a position follow-up control system utilizing a compensated armature-excited dynamo-electric machine for power amplification without limitation as to the percentage compensation. Such is concluded to be a reasonable construction of the '685 specification, which, on one hand, talks of opposing armature reaction, achieving gains as high as 25,000 to 1 and leaving but a small residual of power to be overcome, but, on the other hand, fails to refer to 100% compensation per se or to substantial neutralization of control axis armature reaction flux, operating conditions clearly called for in the '992 patent. This is especially meaningful where the inventors were aware of the distinctions prior to filing the '685 application but made no reference to them in the '685 application.

It is, therefore, concluded that the compensation of the dynamo-electric machine set forth in claim 7 ranges from 75 to 125% while the compensation of the dynamo-electric machine set forth in claim 11 of the '685 patent has no percentage limits.[3]

[3] Although not raised by the parties, the validity of claim 7, in view of the requirements of 35 U.S.C. §112, is questionable. Specifically, the range of compensation of 75 to 125% recited in claim 7 is not supported by the '685 specification. Although the specification does not explicitly limit the degree of compensation, a careful and reasonable interpretation of the specification dictates that the broadest reasonable range that can be assumed to be disclosed is compensation ranging from a minor amount to less than 100%. It would not be reasonable to assume that, absent explicit language, a compensation of 100% or greater was intended. The 75 to 125% range disclosed in an original claim finds no support and, in fact, to the extent it refers to 100% or greater compensation, is

Obviousness

Having established the scope to be afforded the claims in suit, attention is next directed to defendant's argument that the claims are invalid because they fail to comply with the statutory standard set out by 35 U.S.C. § 103 (1970).[4] The validity of claims 7 and 11 must be adjudged in the context of the guidelines enunciated in *Graham v. John Deere Co.*, 383 U.S. 1, 17, (1966), wherein the Supreme Court formulated the test of obviousness based upon a consideration of the relevant prior art, the differences between the claims in issue and that prior art, and the level of ordinary skill in the relevant technological art.

Defendant asserts the relevance of the following seven prior art references, only one of which, French Patent No. 812,451 to Japolsky, was cited by the patent examiner during the prosecution of the application which matured into the '685 patent:

U.S. Patent Re. 16,667	Hewlett, *et al.*
French Patent 812,451	Japolsky
U.S. Patent 1,684,132	Hewlett, *et al.*
U.S. Patent 1,985,981	Edwards
U.S. Patent 1,684,138	Nixdorff
U.S. Patent 2,412,864	Bowman
British Patent 420,167	Pestarini

The pertinence of those references not considered during the examination process seriously weakens the usual presumption of validity afforded all patents under 35

contrary to the teachings of the specification. The specification, moreover, was never amended during prosecution to include such a range.

Claim limitations defining the subject matter of an invention can never be disregarded and, since the specification cannot be reasonably interpreted to support the full range of compensation set forth clearly by claim 7, the claim may very well be invalid for undue breadth. *See In re Sabatino*, 480 F.2d 911, 178 USPQ 357 (C.C.P.A. 1973).

[4] 35 U.S.C. § 103 (1970) provides:

"A patent may not be obtained though the invention is not identically disclosed or described as set forth in section 102 of this title, if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains. Patentability shall not be negatived by the manner in which the invention was made."

U.S.C. § 282 (1970 & Supp. V 1975). *Bolt, Beranek & Newman, Inc. v. McDonnell Douglas Corp.*, 521 F.2d 338, 340, 187 USPQ 142, 144 (8th Cir. 1975), *cert. denied*, 423 U.S. 1073 (1976); *Ellicott Mach. Corp. v. United States*, 186 Ct.Cl. 655, 405 F.2d 1385 (1969). In addition, it should be noted that all of the above patents, except Japolsky and Pestarini, were assigned to and owned by plaintiff corporation.

Six of the references introduced into evidence by defendant provide ample insight into the general state of the position control art at the time the '685 invention was developed.

The French Patent 812,451, granted to Nicholas Japolsky on February 1, 1937, discloses a system for maintaining two objects in positional correspondence. Displacement recorders detect the positional disagreement between the two objects and forward an error signal to a dynamo-electric generator which amplifies and supplies current to a d.c. motor for driving one object into positional correspondence with the other.

Dr. Martin A. Edwards taught a basic positional servo for maintaining two objects in positional correspondence wherein selsyns provide a voltage signal indicative of positional error between the two objects which is converted to an amplified current by appropriate electric valves. The amplified current is then used to drive a d.c. motor for controlling the movement of one object to achieve correspondence with the other. United States Letters Patent No. 1,985,981 issued to Dr. Edwards on January 1, 1935.

United States Reissue Patent No. 16,667 was issued to Edward M. Hewlett, *et al.*, on July 5, 1927, for an invention entitled "Means for Reproducing Position." The patent discloses yet another system for maintaining positional correspondence between two objects. A voltage signal indicative of positional error between the two objects is produced by a pair of induction or selsyn devices connected therebetween. The signal is amplified by a pair of electron discharge amplifier tubes and then impressed on the grid of a second pair of electron discharge tubes for supplying amplified current to the armature of a d.c. motor which drives one of the objects into correspondence with the

other. The specification discloses that additional amplification of the control current may be obtained by the use of one or more electric generators for further amplification of the current output from the electric tubes.

Hewlett, *et al.*, Patent No. 1,684,132, issued on September 11, 1928, discloses a position control system which teaches the same relevant position control apparatus as the Hewlett, *et al.*, Reissue Patent.

United States Patent No. 1,684,138 issued to Samuel P. Nixdorff on September 11, 1928. Nixdorff developed a position control system similar to those above. Disclosed in the patent was the teaching that, after amplification by a pair of electric tubes, the gain of a position control system could be further enhanced by using a pair of cascaded generators to further amplify the current from the electric tubes before application to the drive motor for the driven object.

Yet another position control system is shown in United States Patent No. 2,412,864, which issued to Kenneth K. Bowman on December 17, 1946. The patent is based on an application filed in the United States Patent and Trademark Office on August 20, 1937. As disclosed in the patent, a driven object is controlled by a d.c. motor which is in turn responsive to voltage signals from a Wheatstone bridge. The bridge generates voltage signals indicative of positional disagreement between the driven object and a pilot device. Selsyn devices provide fine and coarse control and are connected to the two objects such that they provide a signal to the bridge indicative of the positional error. The error signal is modified by an anti-hunt network prior to application to the drive motor. Bowman, *et al.*, essentially teach the same system shown by the '685 patent except for amplification of the error signal by a dynamo-electric machine.

Both Hewlett, *et al.*, patents and the Nixdorff patent thus teach a follow-up control system which includes a motor for driving an object into positional correspondence with a pilot device in response to a signal indicative of positional disagreement. However, these prior art patents all disclose the use of electric tubes or cascaded generators for supply of current to the drive motor whereas claim 11

calls for a compensated armature-excited dynamo-electric machine to perform that function.

Similarly, all of the references previously discussed teach follow-up control systems which include a motor for driving an object, *i.e.*, a gun or search light, into positional correspondence with a pilot device in response to a signal indicative of positional disagreement. The prior art, however, utilizes electronic tubes, cascaded generators, or a basic dynamo-electric machine for supplying current to the drive motor while claim 7 calls for a 75 to 125% compensated armature-excited dynamo-electric machine for such current supply.

Resolution of the obviousness of claims 7 and 11 involves slightly different questions. With respect to claim 11, it is necessary to determine whether or not it would have been obvious to one of ordinary skill in the position follow-up control art, at the time the '685 invention was made, to utilize an armature-excited dynamo-electric machine with any degree of compensation, for supplying current to the driving motor of a position control system such as shown by the Hewlett, *et al.*, and Nixdorff references. With respect to claim 7, it must be determined whether or not it would have been obvious to one of ordinary skill in the position follow-up control art at the time of the invention of the '685 patent to utilize an armature-excited dynamo-elctric machine having either partial or 100% or greater compensation on the control axis for supplying current to the drive motor of a position control system such as those illustrated by any of the references described above. As will be seen, it is concluded that both claims 7 and 11 are invalid because they fail to meet the requirements of 35 U.S.C. § 103.

An analysis of British Patent Specification 420,167 by Giuseppe Massimo Pestarini, received in the United States Patent and Trademark Office Library on January 8, 1935, shows that compensated armature-excited dynamo-electric machines were known in the art at the date of filing of the application which matured into the '685 patent. The Pestarini machine is compensated on the control axis by a compensating field winding interposed in series between the load and load brushes. The effect of the winding is described at p. 4, lines 20 to 27, of the Pestarini patent:

> The coils [series compensating windings] are wound so as to excite a magnetic flux in a direction to assist the flux produced by the main field coils 14, 15, 16, 17. This compensating winding partially neutralises [sic] the armature flux along the axis b,d and enables the ampere turns of the coils 14–17 to be reduced.

The patent further states at p. 4, lines 95 to 103, that:

> The current in the load circuit 7, which passes through the coils indicated by C [series compensating windings] produces a flux which assists the flux produced by the windings indicated by SW [main field winding] and consequently reduces the amount of energy required to be supplied from the source connected to the terminals 8, 9 of the winding SW.

Pestarini teaches an armature-excited dynamo machine having a series compensating winding which partially neutralizes the armature reaction flux. The result, as is the case in machine 14 of the '685 patent, is a reduction in the number of ampere turns of the control winding of Pestarini's motor. The reduction in ampere turns of the control winding reduces the inductance of the system to improve the system's time constant or response. In addition, the system's gain is greatly increased.

As is the case generally, whenever a 35 U.S.C. § 103 obviousness test is being applied, it is critical to the analysis to deliberately guard against using the teaching of the patent in suit in arriving at the conclusions. The above observations regarding the Pestarini patent, as well as the following disclosures, insure against any misapplication of the process and guarantees the integrity of the results reached in this instance.

While Pestarini does not teach specific applications of his machine, he does broadly suggest its utility "where high values of current are required in the consumption circuit." Indeed, a machine for improving system gain, which finds particular use where high current outputs are needed, is disclosed. Certainly, the Pestarini patent discloses a solution to overcoming a number of the below-quoted prior art deficiencies outlined at col. 1 of the '685 patent:

> Heretofore, follow-up systems have been utilized in which the motor was supplied from electric valves. Although such systems possess a sufficiently high degree

of accuracy, they have other limitations, and there are many applications in which it is desirable that means other than electric valves, *e.g.*, dynamo-electric machines, be utilized for supplying current to the driving motor. However, dynamo-electric machines have windings that contain inductance and inductance causes delayed or lagging currents. The result of this, especially in a follow-up system having several stages of amplification, is that the restoring force of the driving motor is still active when the driven object reaches correspondence with the pilot device, and this produces generation of self-excited mechanical oscillations usually referred to as "hunting." Accordingly, a further object of this invention is the provision of a follow-up control system in which the driving motor is supplied from a dynamo-electric machine and in which means are provided for eliminating hunting without sacrificing sensitivity of the system.

Plaintiff, in arguing against the obviousness of combining Pestarini with the position control references of record, points out that none of the prior art systems suggest the use of an armature-excited dynamo-electric machine for any purpose. Further, plaintiff urges that not only does Pestarini not suggest any specific application for a dynamo-electric machine, he clearly does not teach that it can be used as an amplifier in a position control system.

The fallacy of these contentions is that they ignore the level of skill in the art as demonstrated by patents such as those issued to Hewlett, *et al.*, and Nixdorff. Those patents illustrate that the general level of skill in the position control art had developed to the point where position control systems utilizing a variety of amplifiers for amplification of the positional disagreement signal were abundant. Moreover, it was during this time frame and in this technical environment that Pestarini disclosed his armature-excited dynamo-electric machine for use where high values of output current were necessary. One embodiment of his disclosure suggests the use of a compensating winding on a control axis for opposing the armature reaction flux of the load current and reducing the control winding requirement. Implementation of such an embodiment results in improved system gain. The specification of the '685 patent also, as has been previously explained,

speaks to prior art shortcomings such as the use of electronic tube amplifiers and the high inductance in windings of prior art dynamo-electric machines.

Given this general state of the art, it would have been clearly obvious to one of ordinary skill in the art, at the time of the '685 invention, to use the Pestarini compensated armature-excited dynamo-electric machine as an alternative to electronic tube amplifiers or cascaded generators for power amplification in position control systems such as shown by Nixdorff and Hewlett, *et al.* This is especially true in view of the advantages which Pestarini discloses for his compensated armature-excited machine, *i.e.*, neutralization of the armature flux, reduction of the control winding requirement, and improved system gain over conventional dynamo-electric machines. The substitution of Pestarini would amount to nothing more than the substitution of one well known power amplifier with its attendant advantages for another.

Further, it also would have been obvious to one of skill in the art, at the time of the '685 invention, to vary the compensation as disclosed by Pestarini to any desired percentage that was needed in a particular system to achieve the best required results. Obviously, once the advantages of compensation and its effect on a dynamo-electric machine had been disclosed, the exact degree of compensation would have been no more than a matter of choice based on the particular power output needed and the desired system gain.

It is, accordingly, concluded that it would have been obvious to incorporate Pestarini's compensated dynamo-electric machine in such prior art position control systems as have previously been discussed to obtain a tubeless positional control system which had low inductance, a quick response, and increased power gains.

To the contrary, plaintiff contends that there was no way to have anticipated the advantages of highly improved system gain, improved system time constants, and variable current output, which result from the use of a 100% or greater series compensated dynamo-electric machine in a position control system prior to the teachings of Alexanderson, *et al.* The simple answer to plaintiff's position, as has

previously been pointed out in establishing the scope of the claims in suit, is that claims 7 and 11 do not require that the armature-excited dynamo-electric machine be compensated to 100% or greater. Thus, the presence or absence of a variable current output, a characteristic which is peculiar to 100% or greater compensation, is of no moment to deciding whether or not claims 7 and 11 are obvious within the meaning of 35 U.S.C. § 103.

In addition, while Pestarini does not specifically state that a 25,000 to 1 gain can be achieved through the use of his machine, he does teach improved gain per se.

Finally, plaintiff argues that utilization of the Pestarini machine in a position control system would be in direct contravention of the teachings of the Pestarini system. For support, plaintiff contends that the Pestarini machine is only partially compensated in order to provide a constant current output which is proportional to the input signal. Plaintiff, therefore, argues that a fully compensated machine, *i.e.*, 100% or greater compensation, would destroy the constant current characteristic and the intent of the Pestarini patent. Plaintiff's argument fails for the obvious reason that claims 7 and 11 embrace partial compensation, and this is clearly disclosed by Pestarini.

The conclusion is thus inescapable that it would have been within the ordinary level of skill in the art to use a compensated dynamo-electric machine such as disclosed by Pestarini in any of well-known position control systems discussed hereinabove to reduce the inductance of the system, increase the system's response, and, as well, increase the system's gain. Additionally, since the Pestarini patent teaches that increased system gains would result through the neutralization of armature flux by the use of a compensated field winding, it would have been within the level of ordinary skill in the art to adjust the compensation according to the system's desired gain. Thus, claim 7, which calls for a compensation of 75 to 125% and, as well, claim 11, which does not specify the amount of compensation required, are both invalid in view of the Pestarini teachings when combined with the Hewlett, *et al.*, or Nixdorff systems.

Patent No. 2,679,138

The third and final patent in suit, United States Patent No. 2,679,138 (hereinafter referred to as the "Kane" patent), was issued to Garold A. Kane on May 25, 1954. The patent was based on an application filed in the United States Patent and Trademark Office on May 19, 1937, and is entitled "Control System."

Plaintiff alleges that the inventions defined by claims 7 and 8 of the Kane patent have been manufactured and/or used by defendant without license or lawful right through the reconstruction of 5"/38 caliber, single Mark 30 gun mounts. Moreover, plaintiff alleges unlawful manufacture and/or use by the United States Government of a multiplicity of accused devices which are alleged to read on the invention defined by claim 17 of the Kane patent. As will be explained hereinbelow, the inventions defined by claims 7 and 17 of the Kane patent are concluded to be invalid. Claim 8 of the Kane patent, on the other hand, is held to be valid.

The Kane Patent Position Control System

The Kane patent broadly relates to hydraulic follow-up position control systems wherein a hydraulic transmission is utilized to drive a driven object such as a gun into positional correspondence with a pilot device such as a telescope in a stable and accurate manner. Movement of the gun is controlled in response to an error signal representative of the positional disagreement between the gun and telescope. Additionally, hunting by the gun is prevented by providing a modifying signal for the basic error signal which is representative of the first time derivative or rate of change of positional disagreement. The combination of the error signal and its first derivative controls the movement of the gun to assume the desired position in a stable and accurate manner.

The hydraulic transmission is composed of an A-end variable displacement pump and a B-end motor, the output shaft of which is connected through suitable gearing to the gun. The transmission also contains a tilt box, the position

of which determines the displacement of the pump. In turn, the tilt box position is controlled by a stroking piston and cylinder. Although not referred to as such in the Kane specification, the hydraulic transmission and the stroking piston comprise the "power drive" of the position control system.

A stroke control valve communicates with the stroking piston and cylinder by means of hydraulic lines. Hydraulic fluid is thus supplied from the stroke control valve to one side or the other of the stroking piston and cylinder, to drive the piston, tilt box, transmission and, ultimately, the gun in one direction or the other.

The stroke control valve is in turn operated by a combination of two factors. One factor is the basic error signal representing the positional disagreement between the telescope and the gun. Selsyns connected to the telescope through suitable gearing and to the output shaft of the hydraulic transmission generate an error signal representative of the positional disagreement between the telescope and gun. The error signal is then amplified. The Kane patent discloses utilizing either an electric valve amplifier or a hydraulic amplifier for this purpose. The hydraulic amplifier comprises a valve and a piston connected in such a manner as to amplify the error signal and supply this amplified error signal to the stroke control valve by way of a rigid pivotal lever connected therebetween.

The second factor making up the control signal to the stroke control valve is a signal which modifies the basic error signal to prevent hunting and provide stable operation. This modifying signal is generated by a hydromechanical lead network composed of a valve and a piston combination connected to the pivotal lever between the hydraulic amplifier and the stroke control valve in such a manner as to modify the basic error signal in accord with the rate of change of positional disagreement between the telescope and gun.

The selsyns, hydraulic amplifier, hydromechanical lead network and the stroke control valve form the "regulator" of the position control system, a term not utilized in the Kane specification but frequently used in the art.

The system operates as a hydraulic follow-up position control system which brings the gun into correspondence with the telescope in an accurate and stable manner.

Claims 7 and 8

Claims 7 and 8 of the Kane patent are directed to the overall follow-up position control system.

Claim 7 reads as follows, broken down into lettered sections element by element for ease of analysis:

7. A follow-up system for controlling (b) a driven object to move into positional agreement with (a) a pilot device comprising

(c) an hydraulic transmission device for driving said object, said transmission device comprising (d) a variable stroke pump, (e) an hydraulic motor supplied from said pump and (f) a device for controlling the stroke of said pump thereby to control the acceleration of said motor,
(g) means for actuating said stroke varying device comprising (h) a cylinder and (i) a piston movable therein and connected to said stroke varying device,
(j) a valve for controlling the supply of fluid pressure to said piston, and
(k) means responsive to positional disagreement of said pilot device and driven object for opening said valve to admit fluid under pressure to said cylinder to move said piston thereby to cause said motor to drive said object toward correspondence with said pilot device, and
(l) means responsive to the rate of change of said positional disagreement for modifying the opening of said valve to vary the acceleration of said motor in accordance with the rate of change of said positional disagreement.

Similarly, claim 8 reads as follows, broken down into lettered sections element by element:

8. A follow-up system for controlling (b) a driven object to move into positional agreement with (a) a pilot device comprising

(c) an hydraulic transmission device for driving said object, said transmission device comprising (d) a variable stroke hydraulic pump, (e) an hydraulic

motor supplied therefrom, and (f) means for varying the stroke of said pump.

(g) means for actuating said stroke varying means comprising (h) a cylinder and (i) a piston movable therein and connected to said stroke varying means,

(j) a valve for controlling the supply of fluid pressure to said cylinder to effect movement of said piston,

(k) means responsive to positional disagreement of said pilot device and driven object for controlling the opening of said valve, and

(l) means responsive to the rate of change of said positional disagreement for modifying the opening of said valve, comprising (m) a second cylinder and (n) piston movable therein, (o) a second valve for controlling the supply of fluid to said second cylinder, (p) a connection between said second valve and second piston and (q) a connection between said connection and said first valve.

Elements (a) through (k) of both claims 7 and 8 recite essentially the same structure, *i.e.*, a pilot device and driven object, a hydraulic transmission having an A-end pump, a B-end motor and a tilt box for varying the pump displacement, a stroking piston and cylinder for controlling the tilt box, a stroke control valve for controlling the stroking piston and means responding to the positional error for operation of the stroke control valve in accordance with the error signal.

Additionally, claim 7 broadly calls for means responding to the rate of change of positional error for modifying the error signal in accordance therewith. Claim 8 recites this same rate responsive means but goes on to specify that the rate responsive means comprises a second piston and cylinder and a second valve for controlling the supply of fluid thereto with connections between the second valve, second piston and the stroke control valve.

Validity

Defendant asserts seven United States patents against claims 7 and 8 of the Kane patent, some of which are highly pertinent to the claimed invention and none of which were cited by the patent examiner during the prosecution of the application upon which the Kane patent is based. As stated earlier in this opinion, the usual

presumption of validity afforded all patents is inevitably weakened, if not destroyed, in the face of such pertinent prior art. *Bolt, Beranek & Newman, Inc. v. McDonnell Douglas Corp.*, 521 F.2d at 340, 187 USPQ at 144; *Ellicott Mach. Corp. v. United States*, 186 Ct. Cl. at 668–69, 405 F.2d at 1392.

Defendant contends that the prior art renders the inventions defined by claims 7 and 8 invalid under 35 U.S.C. §§ 102 and 103. As the following analysis will reveal, claim 7 is not anticipated by any prior art under 35 U.S.C. § 102, but is invalid for obviousness under 35 U.S.C. § 103. Claim 8, on the other hand, is concluded to recite a patentable and valid invention.

35 U.S.C. § 102(e)

United States Patent No. 2,586,990 (hereinafter referred to as the "990" patent) issued to Edward J. Poitras and James D. Tear on February 26, 1952, for an invention entitled "Control System," and was based on an application filed on April 11, 1935. Defendant contends that the '990 patent anticipates claims 7 and 8 of the Kane patent under 35 U.S.C. § 102(e).[5]

The '990 patent disclosure relates to hydraulic follow-up position control systems wherein a hydraulic transmission is used to drive a driven object into correspondence with a pilot device. The hydraulic transmission has an A-end variable stroke pump, the displacement of which is governed by the position of a tilt box therein, and a B-end motor, the output shaft of which is connected to the driven object through suitable gearing. A stroking piston and cylinder control the position of the tilt box. In turn, the displacement of the stroking piston is controlled by a stroke control valve, the input to which is a combination of factors.

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[5] 35 U.S.C. § 102(e) (1970 & Supp. V 1975) provides: "A person shall be entitled to a patent unless—

. . . .

"(e) the invention was described in a patent granted on an application for patent by another filed in the United States before the invention thereof by the applicant for patent * * *."

A basic error signal, representing positional disagreement between the pilot device and driven object, is one of the input factors to the stroke control valve. A pair of cams connected to the pilot device and the output shaft of the hydraulic transmission moves the valve rod of a pilot valve in proportion to the positional difference between the pilot device and output shaft of the hydraulic transmission. Motion of the pilot valve is imparted to a plunger or piston which, in turn, controls the movement of the stroke control valve by means of hydraulic connections thereto. The pilot valve and plunger form a hydraulic amplifier for the error signal.

The system disclosed by the '990 patent also includes means for modifying the basic error signal, the effect of which is to maintain a stable system and prevent hunting. A needle valve augments the oil volume in the lower chamber of the plunger-piston, in response to movement of the plunger, as a function of the first time integral of the plunger position. Thus, the input to the stroke control valve from the plunger is a function of the error plus the first time integral of the error. Additionally, the movement of the stroking piston causes a change in the oil volume of a chamber located within the stroking piston which ultimately provides a degenerative piston position feedback term to the stroke control valve.

The total control signal to the stroke control valve is representative of the error plus the first time integral of the error minus a feedback term representing stroking piston position.

The '990 patent does not anticipate either claim 7 or claim 8 of the Kane patent under 35 U.S.C. § 102(e). Simply stated, the '990 patent discloses a follow-up system showing all the elements of the claimed systems except, "means responsive to the *rate of change of said positional disagreement* for modifying the opening of said valve to vary the acceleration of said motor *in accordance with the rate of change of said positional disagreement*" (emphasis added) as required by claim 7, *ante* at 674, *supra*, and as more specifically described in claim 8 of the Kane patent. The '990 patent does not disclose any structure which responds to the *rate of change* of error for modifying the

basic error signal to the stroke control valve. Rather, the '990 patent discloses a follow-up system including structure which responds to the *first time integral* of the error and *stroking piston position feedback* for modifying the basic error signal to maintain system stability. To anticipate a claim, a prior art reference must show each and every element claimed. Short of this, anticipation does not exist. *In re Royka*, 490 F.2d 981, 984, 180 USPQ 580, 583 (C.C.P.A. 1974).

Obviousness

Defendant asserts that claims 7 and 8 of the Kane patent are obvious within the meaning of 35 U.S.C. § 103 as a result of the teaching of the '990 patent and the state of the art at the time of the Kane invention. Following the three-level analysis set forth by the Supreme Court in *Graham v. John Deere Co.*, 383 U.S. at 17, the discussion now focuses on the state of the prior art.

Prior to the Kane invention, it was well known in the position control art that the first time derivative of the positional error could be used to provide and would indeed provide stability in servomechanisms.[6] In September of 1934, H.L. Hazen published an article, entitled *Theory of Servo-Mechanisms*, which showed that not only the first time derivative but higher derivatives as well could be used to improve the stability of follow-up positional servomechanisms.[7]

Indeed, United States Patent No. 2,406,324, which issued to Arthur P. Davis on August 27, 1946 (hereinafter referred to as the "Davis" patent), for an invention filed on September 6, 1933, entitled "Gun Control System", embodies the practical realization of this concept.

The Davis patent discloses a follow-up position control system utilizing a basic error signal representative of positional disagreement between a pilot device and driven object for control of a hydraulic transmission to drive the driven object into correspondence with the pilot device. The

[6] *See* Minorsky, *Directional Stability of Automatically Steered Bodies*, 34 J. AM. SOC'Y NAV. ENGRS., 280–309 (May 1922).

[7] *See* finding 200.

system includes an anti-hunt device for modifying the error signal to prevent gun oscillations about the point of correspondence. The anti-hunt device produces a rate of change of error signal for modifying the error signal. While the anti-hunt rate of change device disclosed by Davis is not identical structurally to the piston and valve rate of change mechanism specifically shown in the Kane specification and set forth in claim 8 of the patent, Davis had nonetheless implemented the broad concept of utilizing rate of change of positional disagreement in a follow-up position control system for modifying the basic error signal to prevent hunting by the driven object.

Similarly, United States Patent No. 2,421,230, which issued to George Agins on May 27, 1947, for an invention filed on May 13, 1936, and entitled "Electro-Hydraulic Position Control System" (hereinafter referred to as the "Agins" patent), discloses another practical embodiment incorporating a rate of change of error signal in a follow-up control system utilizing a hydraulic transmission to drive a driven object into positional agreement with a pilot device for modifying the basic error signal and providing stability.

The system disclosed in the Agins patent utilizes positional disagreement between the pilot device and driven object as the basic error signal. Tachometers connected to the pilot device and driven object provide velocity signals which are used to prevent hunting by the driven object. The combined effect of the two velocity signals is to provide a stabilizing input which is a function of the first time derivative of the positional disagreement. Thus, the Agins patent shows yet another system implementing the broad concept of using rate of change of positional disagreement for modifying the basic error input in a follow-up position control system to prevent hunting.

The following patents introduced into the record during trial round out the state of the art at the time of the Kane invention.

United States Patent No. 2,213,968 was granted to Edwin L. Rose on September 10, 1940, for an invention filed on October 29, 1936, entitled "Power Transmission." United States Patent No. 2,189,823 was granted to Harry F. Vickers and Norman B. Frost on February 13, 1940, for an

invention filed on August 1, 1935. United States Patent No. 2,343,386 was granted to Messrs. Poitras and Tear on March 7, 1944, for an invention filed on November 14, 1935. Finally, yet another patent, United States Patent No. 2,614,390 was granted to Messrs. Poitras and Tear on October 21, 1954, for an invention filed on January 11, 1935. The teachings of these prior art patents are cumulative to the references described fully *supra*.

Comparing claim 7 with the prior art, it has already been stated that the Poitras '990 patent discloses a follow-up position control system which includes all the elements of claim 7 except for element (1), which calls for a rate of change of error responsive means. Similarly, the Poitras '990 follow-up position control system includes all of the elements of claim 8 except for the rate responsive means broadly recited in element (1) of the claim and more particularly described by elements identified as (m) through (q).

Specifically, it should be recalled from the previous description of the Poitras '990 patent that it discloses a basic hydraulic follow-up position control system wherein an error and error modifying input are applied to a stroking piston from a stroke control valve for control of the tilt box of a hydraulic transmission, the output shaft of which drives an object into correspondence with a pilot device. Mathematically, the error modifying input generated in the Poitras '990 system represents the integral of the error minus stroking piston position feedback. It is this error modifying input which provides stability to the follow-up system and prevents hunting by the driven object.

With respect to claim 7, defendant's 35 U.S.C. § 103 argument turns on whether it would have been obvious to one of ordinary skill in the position control art at the time of the Kane invention to provide stability in the Poitras '990 system by employing means responsive to the first time derivative of error for modifying the basic error input alternatively to the means responsive to the first time integral of the error and piston position feedback which are specifically shown in the Poitras '990 system. Similarly, with respect to claim 8, the inquiry is whether the *specific*

rate responsive means claimed would have been an obvious alternative to the integrating and feedback means used in the Poitras '990 patent. The resolution of these questions necessarily involves a determination of the general level of skill in the art at the time of the Kane invention.

The publications by Hazen and Minorsky illustrate that the concept of utilizing the rate of change of system error to provide a modifying component for a basic system error signal in a position control system for the purpose of stabilizing system operation was well known prior to the Kane invention. Indeed, the patents to Davis and Agins both show that it was within the level of ordinary skill in the art prior to the Kane invention to embody this concept in a practical and operative follow-up position control system. Both patents disclose hardware for generating a rate of change of positional disagreement input to modify the basic positional disagreement input and enable a stable follow-up position control operation.

Given this general level of skill in the art, the conclusion is inescapable that the invention defined by claim 7 of the Kane patent would have been obvious to one of ordinary skill in the position control art at the time it was made. It is specifically concluded, in view of the prior art in existence at the time of the Kane invention, that it would have been obvious to persons skilled in the art to substitute the hardware for modifying the basic positional disagreement signal disclosed in patents such as Davis and Agins for the error modifying means taught by the Poitras '990 patent to thus obtain the same combination of elements as defined by claim 7.

In this manner the error modifying means specifically shown by the '990 patent, *i.e.*, means responsive to the first time integral of the positional disagreement and stroking piston position feedback, will have been replaced by the hardware disclosed by Davis and Agins for generating a rate of change of positional disagreement. Such a substitution renders the system defined by claim 7 obvious and the claim invalid.

The propriety of this conclusion is clearly brought into focus when one additionally considers that a signal representing system error plus the rate of change of system

error is the equivalent of a signal representing system error plus the first time integral of system error minus stroking piston position, a fact established at trial and agreed to by expert witnesses for both plaintiff and defendant. Whether or not the mathematics was actually known at the time of the '138 Kane invention, the truth is that the devices were in fact equivalent, *i.e.*, operating in substantially the same way, performing substantially the same function, and producing substantially the same result. Thus, upholding the validity of claim 7 would afford an undeserved patent status to a system which embodied a well-known element, a rate of change of error means, for an equivalent well-known element, integral of error and piston position means, in an otherwise conventional position control system.

The same result cannot, however, be reached with respect to the invention defined by claim 8 of the Kane patent, which does not broadly call for a rate of change of error means to provide stability but rather recites specific structural elements as comprising the rate of change of error means. The specific rate of change of error means recited in claim 8 is not found in any of the prior art. Nor is there any suggestion from the prior art of record that would compel the conclusion that such a specifically enumerated means would have been obvious to one of ordinary skill in the art at the time of the Kane invention. Since the validity of claim 8 is not challenged on any other grounds,[7a] it is concluded that claim 8 of the Kane patent is valid.[8]

[7a] Defendant contends that it also raised the invalidity defense of old combination which it characterizes as the mere aggregation of a number of old parts or elements which, in their aggregation, perform or produce no new or different function or operation than that theretofore performed or produced by them (citing *Lincoln Eng'r Co. v. Stewart-Warner Corp.*, 303 U.S. 545, 549 (1938)), even though one of the combined parts may have been improved in and of itself. The answer to this defense, if raised, is that, as shown in the findings, the combination in claim 8 was not such an old combination but a new combination. Claim 7 represents an obvious new combination while claim 8 is a non-obvious new combination. [footnote by the court]

[8] Defendant has challenged the validity of claim 7 under 35 U.S.C. § 102 on the basis of the Davis patent, as well as on other combinations of the prior art references described *supra* under 35 U.S.C. § 103. These other contentions need not be addressed in view of the invalidity of claim 7 on grounds already discussed. It should be noted, however, that none of the prior art patents show each and every element of claim 7.

The 5-inch 38 Caliber Single Mark 30 Gun Mounts

The accused device with respect to claim 8 of the Kane patent is the 5-inch 38 caliber single Mark 30 gun mount (hereinafter referred to as the "5"/38 single Mk 30" gun mount). Plaintiff contends that these gun mounts, originally manufactured during the 1930's and 1940's for use by the Naval fleet, were overhauled during the 1962 to 1971 timeframe by the Navy under the Ordnance Replacement Program at the Naval Ordnance Station in Louisville, Kentucky (hereinafter "NOS Louisville") and that such activity constituted unauthorized reconstruction for which plaintiff should be compensated.

In order to evaluate plaintiff's contention, it is necessary to consider and find that defendant not only has reconstructed, as distinguished from repaired, originally purchased and/or licensed follow-up positioning systems, but that the reconstructed systems read literally and substantively on claim 8 of the Kane patent. Attention is initially directed to the latter of these threshold issues.

For reasons which will become clear *infra*, it is concluded that the 5"/38 single Mk 30 gun mounts read both literally and substantively on claim 8 of the Kane patent.

Two separate mechanisms of the 5"/38 single Mk 30 gun mounts are in issue. One is the gun mount with an Mk 39 train indicator-regulator. The other is the gun mount with an Mk 35 elevation indicator-regulator. Since the Mk 39 train and Mk 35 elevation indicator-regulators are structurally identical insofar as the issues before the court are concerned, the following discussion, although limited to the 5"/38 single Mk 30 gun mount in conjunction with the Mk 39 train indicator-regulator, is applicable to both systems.[9]

The 5"/38 single Mk 30 gun mount has an Mk 6 power drive which includes a hydraulic transmission comprising an A-end variable displacement pump and a B-end hydraulic motor. The output shaft of the motor is connected through suitable gearing to the gun mount. A tilt plate

[9] It should be noted that plaintiff only alleges that 5"/38 single Mk 30 gun mounts having either an Mk 39 train or Mk 35 elevation indicator-regulator infringe claim 8 of the Kane patent. Gun mounts not having either of the above-identified indicator-regulators are therefore not accused or considered.

controls the pump displacement as a function of its position. The position of the tilt plate is controlled by a stroking piston and cylinder.

In the instances where an Mk 39 train indicator-regulator is used with a 5"/38 single Mk 30 gun mount, a fine control synchro provides an output which is representative of the positional disagreement or error between the pilot device or director and the gun mount. An output is provided, in automatic control, in response to a command signal relayed from the director through a computer and also in response to a mechanical response signal from the output shaft of the hydraulic transmission.

The error signal is amplified in a hydraulic amplifier which includes a synchro valve and piston. By means of a rigid but pivotal interconnecting lever, the amplified error signal is applied to a stroke control valve which supplies hydraulic fluid to one side or the other of the stroking piston.

Connected to the interconnecting lever between the hydraulic amplifier and stroke control valve is a stabilizing valve and piston combination which modifies the error signal applied to the stroke control valve as a function of the rate of change of positional disagreement between the director and gun mount. Hence, the stroke control valve operates the stroking piston and accordingly the hydraulic transmission as a function of the positional error plus the rate of change of positional error all through a time constant.

When the 5"/38 single Mk 30 gun mount is under local control, the hydraulic amplifier does not affect the operation of the gun mount. Rather, the position of the pilot device, which is a handwheel drive assembly in local operation as opposed to the director and computer, is transmitted through suitable gearing for comparison with the B-end output shaft position. System error thus appears as a differential output which is supplied through a local power clutch and crank arm directly to the interconnecting lever leading to the stroke control valve. Otherwise, local and automatic control are essentially identical and the rate of change of positional error is generated as described above.

As described fully in the appended findings of fact, the 5"/38 single Mk 30 gun mount having an Mk 39 train indicator-regulator reads both literally and substantively on claim 8 of the Kane patent. In fact, the accused device is almost a mirror image of the system shown in Fig. 4 of the Kane patent, which is reproduced in the findings of fact.

Defendant maintains that the accused device does not read on claim 8 of the Kane patent since it does not have "means responsive to positional disagreement of said pilot device and driven object" as required by element (k) of claim 8, but rather has means responsive to positional disagreement of the pilot device *and the output shaft of the hydraulic transmission.* Apparently, defendant is under the impression that claim 8 requires connection of the synchro directly to the driven object, *i.e.,* the gun mount.

However, the claim language itself does not require such a narrow reading. Moreover, a review of the specification to see what structure the patentee was referring to in the means clause of element (k) dispels any notion that direct connection to the driven object is intended. Rather, the specification clearly demonstrates that the synchro is connected to the output shaft of the hydraulic transmission and that the output shaft position, compared with the position of the pilot device, yields an output representative of the positional disagreement between the pilot device and driven object.

The Kane specification clearly sets this forth at col. 10, lines 15 to 21:

> Since [the] stator [of the synchro] * * * is mechanically coupled to the output shaft * * * of [the hydraulic] transmission * * *, rotation or displacement of the rotor * * * from its zero position is therefore *the difference in positions of the pilot device and output shaft and hence it is the error between gun * * * and telescope * * *.* (emphasis added)

Such a process of interpreting the claim of a patent in light of its specification is a rudimentary and familiar process to this court. *See Autogiro Co. of America v. United States,* 181 Ct. Cl. at 63, 384 F.2d at 397–98; *Tate Eng'r, Inc. v. United States,* 201 Ct.Cl. 711, 719, 477 F.2d 1336, 1340 (1973).

In sum, the 5"/38 single Mk 30 gun mount having either an Mk 39 train or Mk 35 elevation indicator-regulator reads both literally and substantively on claim 8 of the Kane patent. The accused device performs the same functions in the same manner to achieve the same results as the claimed invention. *Autogiro Co. of America v. United States,* 181 Ct. Cl. at 66–67, 384 F.2d at 399–400.

*The Kane Limit Stop Invention**

To this point this decision has been concerned with structure that was necessary to insure that a gun would be able to accurately and quickly move into positional agreement with a pilot device. However, it is an equally important concern in follow-up gun positioning systems that the gun be prevented, while automatically following the position of the pilot device, from reaching a position where it is able to fire upon the ship itself or members of the crew. A simple but unsatisfactory solution to the problem is to merely provide mechanical stops on both sides of the gun mount to restrict its angular movement within permissible limits.

The Kane patent goes beyond this rudimentary solution and additionally discloses a limit stop mechanism for hydraulically stopping gun movement just prior to its arrival at a mechanical limit stop in order to prevent undesirable wear and damage to the gun or its associated structure. A concise description of the limit stop mechanism, and in fact the only discussion of the limit stop mechanism, appears at col. 15, lines 14 to 46 of the patent. In view of the highly pertinent nature of this disclosure to the issues before the court, the description is reproduced below in toto. As well, that portion of Fig. 4 of the Kane patent illustrating the limit stop mechanism is also reproduced:

"Usually a gun such as the gun 100 is mounted in such a place that it cannot rotate continuously, and accordingly, rigid mechanical stops are provided. It is necessary, therefore, to incorporate a control device that will prevent the hydraulic transmission from driving the gun into the

* Plaintiff does not seek review of the trial judge's adverse holding on claim 17 of the Kane '138 patent.

mechanical stops under power. This device comprises the shaft 143 geared to the gun, crank arm 149, levers 150 and 151, lost motion mechanism 152, centering springs 153, and valve 154. The operation of this feature is as follows:

"As the gun 100 approaches a stop, the point E of lever 150 is moved vertically, and the lever 151 pivoting about the point H takes the lost motion out of mechanism 152 and raises the valve stem of valve 154. At this point in the operation, the piston 108 is in the dotted line position above its central or zero position. The valve 154 now blocks the flow of oil through pipe 111 to the piston 108 from valves 112 and 135, and admits oil to the space above the piston 108 from the pressure tank through pipe 162 and the port 156 of the valve 154, which forces the piston 108 downward towards its central or zero position so that the speed of the transmission is reduced as the gun approaches the mechanical stop, and just before the mechanical stop is reached, the speed is reduced to zero. If the action of the control is such as to cause the gun to rotate away from the mechanical stop, no restriction is imposed by the valve 154, as the flow of oil from the control valves 112 or 135 may pass to the piston 108 through the check valves 157 and 158."

From Stroke Control Valves 112 and 135

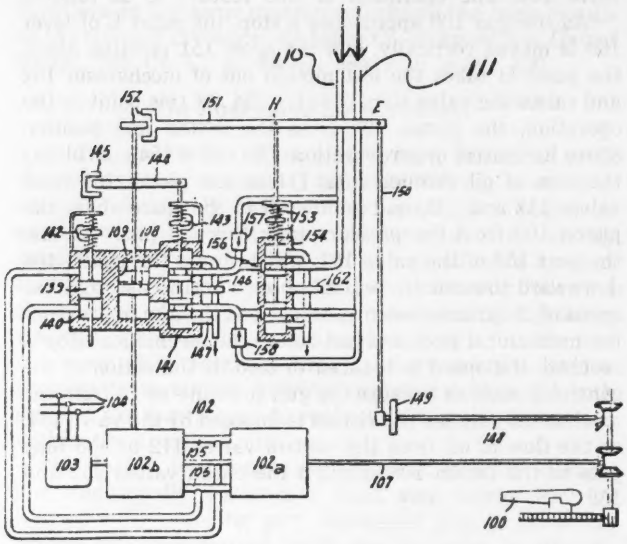

Fig. 4 of the Kane Patent

Limit Stop Operation

The disclosed limit stop mechanism includes a control valve 154 connected to the fluid supply lines 110 and 111, between the stroke control valve 112 and the stroking piston 108.

Control valve 154 includes a spool having upper and lower double land sections and a centering spring 153 so that in normal (nonlimit) operation control fluid is channeled from the stroke control valve 112 to the stroking piston through the center grooves of the land sections of valve 154.

As the gun rotates and begins to approach a mechanical stop, point E of lever 151 is raised vertically through the action of lever 150, crank arm 149 and shaft 148. The latter is connected through appropriate gearing to the gun and initiates movement of point E when the gun is approaching limiting position.

As point E continues its vertical ascendency, lever 151 pivots about point H (connected to the control valve 154 through a valve rod and the centering spring 153) until the pronged lever 151 contacts the lost motion mechanism 152. When this occurs further vertical motion of point E raises point H which, in turn, moves valve 154 in an upward direction.

As valve 154 is raised, it blocks the flow of oil that normally flows between the stroke control valve and the stroking piston by way of hydraulic line 111.

Port 156, which connects valve 154 to the upper chamber of piston 108 and, as well, the corresponding unmarked port connecting valve 154 to the lower chamber of piston 108 are larger than the input ports of valve 154 to which hydraulic lines 110 and 111 are connected. Thus, simultaneous with the blockage of flow to piston 108 from the line 111 due to the upward movement of valve 154, high pressure fluid is admitted through pipe 162 and port 156 to the upper chamber of piston 108. Similarly, the pressure in the lower chamber of piston 108 is simultaneously diminished as movement of valve 154 causes the lower chamber to communicate with drain through the unmarked enlarged lower port of valve 154. Piston 108 is urged down towards its neutral position as a result of this differential pressure across it. The specification states that the piston 108 is brought to rest at its neutral position but does not describe how this is accomplished. Nonetheless, since movement of gun 100 is controlled by the stroking piston 108, gun 100 will only come to rest prior to reaching a mechanical stop if stroking piston 108 comes to a complete stop.

According to the Kane specification, check valves 157 and 158 and their associated by-pass lines do not comprise part of the limit stop mechanism which brings the gun to rest prior to contact with a mechanical limit stop. On the

other hand, the check valves and by-pass lines are necessary to allow the gun to be brought away from the mechanical limit stop by allowing high pressure fluid which would otherwise be blocked by valve 154 to reach the stroking piston.

Claim 17 defines a position follow-up control system incorporating a limit stop mechanism for bringing the driven object to rest prior to reaching a limit position. The claim reads as follows, broken down into lettered sections by element for ease of analysis:

> 17. A follow-up system for controlling (b) an object to move into positional agreement with (a) a pilot device comprising in combination
>
> (c) an hydraulic transmission device for driving said object, (d) a device for controlling the speed and direction of rotation of said transmission,
> (e) a cylinder having a (f) piston movable therein for actuating said control device,
> (g) connections from said cylinder to a source of fluid pressure,
> (h) a valve in said connections,
> (i) means responsive to positional disagreement of said pilot device and driven object for actuating said valve to control said transmission device to drive said object toward correspondence with said pilot device,
> (j) a second valve in said connections between said first valve and said piston, and
> (k) means operable in limiting positions of said object for controlling said second valve to interrupt the supply of fluid from said first valve to said piston and for supplying fluid to said piston to actuate said control device to stop the driving action of said transmission device.

Elements (a) through (i) of claim 17 read on the basic position control system as fully set forth hereinabove in connection with the discussion of claims 7 and 8.

The second valve identified as element (j) in claim 17 reads on the control valve 154.

The "means operable in limiting positions," element (k), reads on lost motion mechanism 152, lever 151, arm 150, crank arm 149 and shaft 148. As will be shown *infra*, check valves 157, 158 and their associated bypass lines are not elements of claim 17.

Defendant asserts the invalidity of claim 17 under 35 U.S.C. §§ 102(e), 102(g), and 103. Additionally, but in a rather oblique fashion, 35 U.S.C. § 112 is asserted as a defense. Finally, defendant asserts that none of the accused devices infringe claim 17. Since, for reasons which will be explained in considerable detail hereinbelow, it is concluded that claim 17 is invalid on the basis of Section 112, the remaining defenses need not and will not be addressed.

The manner of operation of the Kane hydraulic limit stop mechanism has been a continual source of dispute between the parties. As the following analysis will reveal, the Kane patent fails to disclose an operative limit stop mechanism.

Although defendant has gone to great lengths to assert that the Kane patent discloses a mechanically, rather than a hydraulically, operated limit stop mechanism for bringing the stroking piston to neutral and hence the gun to rest, it is beyond peradventure that the Kane patent discloses a hydraulically operated limit stop mechanism. The Kane specification, *see* col. 15, lines 31 to 41, *ante*, at 686–87, clearly provides that upon the blocking of oil from line 111 by valve 154, high pressure fluid from source 162 is admitted to the upper chamber of the stroking piston 108, and it is the high pressure fluid, "*which forces the piston 108 downward* towards its central or zero position so *that the speed of the transmission is reduced* as the gun approaches the mechanical stop, and just before the mechanical stop is reached, *the speed is reduced to zero.*" (emphasis added)

This clearly enunciates a hydraulic coercion of the stroking piston.

Defendant next argues, even assuming that the limit stop operates hydraulically, that the check valves 157 and 158 prevent the gun from coming to rest before its arrival at a mechanical limit stop. Specifically, plaintiff contends that if check valves 157 and 158 allow unrestricted[10] forward flow, no pressure differential can be created across

[10] The parties are in disagreement as to whether a "check valve" by definition connotes unrestricted forward flow or both restricted and unrestricted flow. As can be seen from this opinion, this point becomes irrelevant since claim 17 does not require *any* check valves.

the stroking piston 108 to return it to neutral. Defendant points out that even if control valve 154 blocked high pressure flow from line 111 to the stroking piston, check valve 158 would provide a bypass path to allow that high pressure flow to reach the lower chamber of the stroking piston and neutralize the high pressure provided to the upper chamber of the stroking piston by pressure source 162 through port 156. The result, defendant maintains, would be that the stroking piston would remain in a position where it continued to drive the hydraulic transmission and hence the gun towards the mechanical limit stop.

The simple answer to defendant's argument is evident after a careful reading of the previously-quoted portion of the Kane patent which relates to the limit stop operation. The Kane patent clearly shows that the check valves play no role in bringing the gun to rest just prior to reaching the mechanical stop. The specification, to the contrary, attributes such results to the action of the second valve 154 and the associated limiting means to control it.

Since the Kane specification does not require that check valves 157 and 158 be included as part of means clause (k) of claim 17, they are not necessary to perform the functions recited in the claim and thus will not be read into that clause. *Technitrol, Inc. v. Control Data Corp.*, 394 F.Supp. 511, 185 USPQ 801 (D.Md. 1975).

A comparison of claim 18 with claim 17 confirms the conclusion that check valves and their bypass lines are not to be read into the "means operable in limiting positions" recited as clause (k) of claim 17. As stated earlier in this opinion, such a claim comparison is useful in determining the scope and coverage to be afforded to claims in issue. *Bethell v. Koch*, 427 F.2d at 1374; *Stukenborg v. Teledyne, Inc.*, 299 F.Supp. at 1156.

Claims 17 and 18 are couched in identical language except that claim 18 additionally calls for, "check valves in said connections providing for actuation of said piston by said positional disagreement responsive means to cause said transmission device to drive said object away from said limiting position."

Thus, claim 17 recites a follow-up position control system including a second valve and means operable in limiting positions for controlling that valve to bring the driven object to rest. Claim 18 recites a follow-up position control system including not only the two aforementioned elements but, additionally, check valves for bringing the driven object out of the limiting position.

Summarily, the clear language of claim 17, the fact that check valves are not necessary to perform the position limiting functions recited in claim 17, and a comparison of claims 17 and 18 lead to the inevitable conclusion that check valves are not to be read into claim 17 as part of the clause (k) "means operable in limiting positions."

With this interpretation as background, it is clear that a pressure differential will indeed be created across the stroking piston under limit stop operation which will hydraulically coerce the stroking piston towards its neutral position.

Notwithstanding the above analysis, which was only relevant to establish the meaning of the language used in claim 17, it must be concluded that claim 17 is invalid since it recites, and the specification describes, an inoperative system.

The trial transcript clearly demonstrates that if the control valve 154 *completely* blocks fluid flow from line 111 during the *entire* limit stop operation, there is nothing to stop the stroking piston when it reaches its neutral position. Consequently, the stroking piston 108 will pass its neutral position and reverse the hydraulic transmission, thus driving the gun away from the limit stop.

As this occurs, point E on lever 151 would be lowered, thus simultaneously lowering control valve 154 and bringing the gun back under normal control of the stroke control valve. The stroke control valve and the associated structure will then operate, assuming that the pilot device has not been moved, to reverse the direction of movement of the gun again and drive it towards the mechanical limit stop.

These actions would thus be repeated and the gun would continually oscillate in and out of limiting position. Summarily, the gun would never be brought to rest as

contended by both the disclosure and clause (k) of claim 17, *ante* at 690, which requires:

> means operable in limiting positions of said object for controlling said second valve to interrupt the supply of fluid from said first valve to said piston and for supplying fluid to said piston *to actuate said control device to stop the driving action of said transmission device.* (emphasis added)

Defendant contends that the control valve 154 is disclosed as completely blocking the oil flow from hydraulic line 111 during the entire limit stop operation and thus the disclosed system is inoperative.

Conversely, plaintiff asserts that defendant's view is an unfair and restrictive interpretation of the Kane specification and claims. Rather, plaintiff contends that the Kane specification does not disclose complete blockage by control valve 154 during the entire limit stop operation and that one of ordinary skill in the art at the time of the Kane invention would have read the Kane specification and would have been able to design control valve 154 such that the stroking piston was brought to rest at neutral position. Such a design would have entailed providing a pressure differential as previously described through the initial blockage provided by control valve 154 to move the stroking piston towards neutral. Then, as neutral position was approached, the position of control valve 154 would be varied such that pressure from line 111 was allowed to reach the lower chamber of stroking piston 108 in order to balance and offset the pressure in the upper chamber of stroking piston 108 which is provided from pressure source 162. The action of valve 154 would thus be designed to achieve complete balancing of pressure across stroking piston 108 by the time neutral position was reached, and gun 100 would therefore come to rest.

Having carefully reviewed the Kane specification, the claims and file wrapper and the trial record, it is concluded that the disclosed invention requires a complete blockage of fluid from line 111 during the entire limit stop operation. In addition to the above-described mode of operation being required by the Kane specification, claim 17, as well, calls for a complete blockage of fluid from line

111 during the entire limit stop operation. Accordingly, claim 17 fails to recite an operative combination.

Turning first to the Kane patent, lines 32 and 33 of col. 15 explicitly state that as the control valve 154 is raised it "blocks the flow of oil through pipe 111 to the piston 108." This is the only recitation in the entire Kane specification addressed specifically to the interaction between control valve 154 and the flow of oil from the main hydraulic lines 110 and 111 during limit operation. The plain import of this statement is that no oil passes from line 111 through control valve 154 to the stroking piston during limit operation.

Another statement found in the Kane specification supports this conclusion. At col. 15, lines 43 to 46, the specification recites that when it is desired to move the gun away from limiting position "*no restriction* is imposed by the [control] valve 154, as the flow of oil from the * * * [stroke control valve 112] *may pass to the [stroking] piston 108 through the check valves 157 and 158.*" (emphasis added) The clear implication of this last statement is that no oil would pass to the stroking piston when it was desired to move the gun out of limiting position but for the presence of the check valves and their associated bypass lines, thus confirming the conclusion that when the specification used the term "blocks" in describing the interaction of the control valve 154 and hydraulic line 111, it meant a complete blockage of oil flow from hydraulic line 111 by control valve 154.

Looking also to the patent file wrapper, further support for the conclusion that a complete blockage of fluid from line 111 was required during limit stop operation is found in the patentee's own statements made during the prosecution of the Kane patent in the United States Patent and Trademark Office.

During the patent prosecution, the patentee described the limit stop operation as follows:

> The description of the operation beginning at line 29, on page 19 [which appears at lines 14 to 45 of col. 15 of the patent] has been reversed *in order to make the operation clearer.* In this connection the drawing has been amended to show the position of the piston 108 in dotted lines

above its central or zero position. The specification has been amended to point out that the oil is supplied through the pipe 111 at this point in the operation and that the vertical movement of the valve stem of valve 154 *cuts off the flow of oil from the pipe 111* and admits oil under pressure through the pipe 160 [renumbered 162] and the port 156 to the space above the piston 108 so as to cause the piston to move towards its zero position. (emphasis added)

The clear import of plaintiff's own representations to the Patent Office as to how the system was to operate during limit stop, *i.e.*, "cuts off the flow of oil from the pipe 111" unquestionably requires that no oil passes from line 111 to the stroking piston during limit operation once control valve 154 has been raised.

In short, plaintiff has produced no evidence to support its position that control valve 154 does not completely block oil flow from hydraulic line 111 during the entire limit stop operation. To the contrary, the Kane specification and file wrapper demonstrate clearly that the patentee disclosed a hydraulic limit stop mechanism utilizing a control valve which completely blocks oil flow from the main hydraulic lines during limit operation. Certainly it is beyond question that the patent does not disclose nor describe a mechanism to bring the gun to rest under such conditions.

Claim 17, in embodying the above-described limit stop mechanism, thus fails to recite an operative system since the disclosed and claimed structure is incapable of performing its recited function of stopping the hydraulic transmission and bringing the gun to rest. On this basis, claim 17 cannot stand and is therefore held to be invalid under 35 U.S.C. § 112. *Blohm & Voss AG v. Prudential-Grace Lines, Inc.*, 346 F.Supp. at 1130.

PART II

On the issue of reconstruction versus repair, the court's opinion (borrowing its hard facts from the trial judge but differing in legal analysis, ultimate conclusions, and result) is as follows:

The NOS Louisville Ordnance Replacement Program

Having concluded in Part I, *supra*, that claim 8 of the Kane '138 patent reads on the accused devices, it becomes necessary to determine if defendant's operations at NOS Louisville amounted to an impermissible reconstruction or a lawful repair.[11] To understand the full ramifications of the repair versus reconstruction issue, a certain amount of background facts setting forth the Navy's fleet maintenance program is essential.

A. Prior to 1962, the Navy serviced its fleet on three levels. On-board maintenance, known as organizational level maintenance, was performed by sailors. Ship tenders performed what was referred to as intermediate level maintenance. Finally, major maintenance activities were performed at Naval shipyards. This last activity was known as depot level maintenance. While an exact differentiation between the three levels of maintenance is not felt to be necessary, it should be stressed that depot level maintenance was only considered as a last resort and by definition was concerned with jobs which could not be performed at the other two levels.

During the early 1960's the Navy decided to concentrate all depot level maintenance at a single facility. Louisville Kentucky, where the Navy had purchased an old Westinghouse plant in 1946, was chosen; and, in 1962, a program known as the Ordnance Replacement Program was established at the Naval Ordnance Station, Louisville.

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[11] Claim 8 of the '138 patent defines a patented combination of 17 basic unpatented elements. These elements are found in the accused 5"/38 single Mk 30 gun mount as four basic components, *i.e.* the handwheel drive assembly (element b); the gun, slide, carriage and stand (element a), the Mk 6 power drive (elements c through i) and the indicator-regulators (each including elements j through q).

It is not contended that there is any liability for use of the devices as originally procured before overhauling. (The '138 patent issued in 1954 and expired in 1971; the six-year statute of limitations, 28 U.S.C. § 2501 (1970); 35 U.S.C. § 286 (1970), first ran no later than 1960, the plaintiff taking no action with respect to alleged infringement until 1963). Moreover, under *Calhoun v. United States*, 197 Ct. Cl. 41, 51–53, 453 F.2d 1385, 1391–92 (1972), the manufacture and use of the original item must be considered as licensed and the Government entitled to repair the item without paying further compensation. Conversely, the Government would be liable under *Calhoun* if it reconstructed the patented invention rather than merely repairing the device.

NAVORD Instruction 8300.1, dated November 20, 1967, summarizes the goals of the Ordnance Replacement Program. This directive officially established the Ordnance Replacement Program in 1967. The instruction indicated that:

> The Ordnance Replacement Program was established for the purpose of replacing 15–25 year old ordnance installations on active ships with new or completely rebuilt ordnance from stock. The replacement guns, rocket launchers, and fire control equipments are cycled through NAVORDSTA Louisville or participating activities for complete Ordalting or rebuilding to like new condition prior to issue.

The 5"/38 single Mk 30 gun mount was one of the first equipments to be processed at NOS Louisville. Since 1962 all 5"/38 single Mk 30 gun mounts have been overhauled, if at all, at NOS Louisville under the Ordnance Replacement Program. The trial record establishes that all of the gun mounts were originally manufactured during the 1930's and 1940's, and in any event not later than 1945. Thus, the gun mounts coming into NOS Louisville during the 1960's were on the average 25 to 30 years old. Those gun mounts sent to NOS Louisville were characterized by inordinate amounts of down time while on-board ship and it was the goal of the Ordnance Replacement Program to bring their operation back up to new performance specifications. This meant that an overhauled gun mount would perform according to original manufacturer's performance specifications but with a shorter life span.

The overhaul procedures for the 5"/38 single Mk 30 gun mounts which will now be described typify those used during the 1967 to 1971 timeframe at NOS Louisville. The testimony at trial was insufficient to justify firm conclusions as to the precise nature of the program prior to 1967.[12]

When a 5"/38 single Mk 30 gun mount was removed from a vessel, it became part of a continuous stream of equipment flowing in and out of NOS Louisville under the

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[12] *I.e.*, the evidence was insufficient to justify conclusions as to the precise nature of the overhaul program during the years 1962 to 1967. The Kane patent expired in 1971.

Ordnance Replacement Program. There was little concern for returning a gun mount to the ship from which it was removed. In fact, during the 1966 to 1968 timeframe, virtually all attempts to return a mount to its original vessel were abandoned. Rather, the first available gun mount of similar kind coming out of NOS Louisville was sent to the ship as a replacement, thus minimizing the down time of the ship. This was made increasingly possible since certain vessels were being retired from the fleet and extra 5"/38 single Mk 30 gun mounts were added to the replacement pool.

In removing a gun mount from a ship, it was necessary to sever all cables from the pilot device (director and computer). All air lines were disconnected and the bolts securing the gun mount to the ship removed.

Removal of the gun mount from a ship was performed at a Naval shipyard. After removal, the shipyard replaced all wiring from the director and computer to the gun mount with plug-in cables. The director and computer remained on-board ship. The gun mount was then forwarded to NOS Louisville.

For every five gun mounts that were forwarded to NOS Louisville, approximately three would be in condition to be overhauled. The other two would be scrapped with the components, wherever possible, going to a spare parts pool.

The overhaul operation for all 5"/38 single Mk 30 gun mounts processed at NOS Louisville followed a standard procedure. The condition of a gun mount was first determined by reducing it into its four major components, *i.e.*, train and elevation indicator-regulators, power drive, gun and pilot device. *See* Note 11 *supra*. These major components then went to separate work areas where they were reduced to their smallest readily separable part. All parts would be cleaned and inspected. Parts which were worn, scored, broken or corroded beyond reasonable use would be replaced. The major components were then reassembled. However, in carrying out these operations, no attempt was made to see that the original major components were reassembled together. The gun mount was then tested to see if it met performance specifications.

During the overhaul process, all seals, bearings and wiring would be replaced.

NOS Louisville had its own Annex Supply which housed some parts. A Ships Part Control Center (hereinafter "SPCC") in Mechanicsburg, Pennsylvania, stored spare parts. Among those parts at SPCC Mechanicsburg were some Mk 39 train and Mk 35 elevation indicator-regulators which had never been used or installed on ships previously, notwithstanding that they were some 25–30 years old. Finally, the Naval Ammunition Depot (hereinafter "NAD") in Crane, Indiana, held a pool of scrapped gun mounts from which parts could be cannibalized for use as needed.

As stated *supra*, after major components such as the power drive and indicator-regulator were removed from a gun mount in the central work area, they were forwarded to individual work areas.

The indicator-regulators were completely disassembled in an indicator-regulator area. Standard procedure called for disassembly, cleaning and inspection of all parts, including the individual valves and pistons. Scored valve sleeves or parts having excessive tolerances were replaced. Synchro motors were forwarded to an electrical area for disassembly and overhaul of the electrical sections. The indicator-regulators were completely rewired to replace old wiring with new, fungus-coated wiring to prevent deterioration.

Finally, the indicator-regulators were reassembled and tested. The reassembled indicator-regulator would then be returned to the main work area for installation on whichever gun mount was being overhauled at that time. On the average, at least 1 month would pass from the time work began on an indicator-regulator to the time it was sent back to the main work area for use on the next available gun mount. In sum, there was no concern for mating an overhauled indicator-regulator with the original gun mount from which it had been removed.

The power drive was overhauled in essentially the same manner as the indicator-regulator and, similarly, used on whichever gun mount was on the work stand when it became available.

There was no attempt to return any major components to the gun mounts from which they were originally removed. Further, the reassembled gun mount was shipped to and installed on the ship currently in need.

ORDALT's were also incorporated into the gun mount. ORDALT is an acronym for Ordnance Alteration and is a change or alteration to a piece of equipment that is in use. For example, NAVORD ORDALT No. 3887, dated October 1, 1960, provided instructions for replacing obsolete synchro motors with new performance synchros. The result of such ORDALT's in certain cases was to upgrade the performance of parts of the gun mount beyond the original performance specifications set at the time the gun mount was first manufactured.

The average total overhaul time for a 5"/38 single Mk 30 gun mount was 7 months at an average cost of $100,000.

Overhaul of 5"/38 single Mk 30 gun mounts under the Ordnance Replacement Program went far beyond the depot level maintenance previously performed at Naval shipyards. Shipyard maintenance generally did not involve complete disassembly and mix-match of subassemblies as occurred at NOS Louisville. A shipyard would normally only repair those parts that were not functional at the time the ship came into the shipyard. Further, the gun mount was reinstalled on the same vessel from which it was removed.

B. With respect to the NOS Louisville Ordnance Replacement Program—the only overhaul program said to infringe—it is important, in our view, to bear in mind the following significant facts (which the trial judge did not deem of great importance):

(1). Of the 17 elements of the patented combination, *see* note 11, *supra*, G.E. appears to have itself supplied the defendant, prior to 1945, with at least fifteen elements of the original gun mounts sent to Louisville for overhauling—all except the gun (and accoutrements) and possibly the handwheel drive assembly.[13]

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[13] The preponderance of the evidence is that all the indicator-regulators (8 elements) and at least 1400 power drive units (7 elements) were supplied by plaintiff. There is a dispute as to whether some of the power drive units (incorporated in the original mounts) came, not from G.E., but from a Navy manufacturing installation.

(2). G.E. had also sold to defendant, prior to 1945, a large number of new indicator-regulators which were stockpiled and used as spare parts in overhauling the accused gun mounts. Likewise, it appears that a substantial number of power drives, sold by G.E. to the Navy, were stockpiled for possible use as spares.

(3). Approximately 60% of the gun mounts forwarded to NOS Louisville were in condition to be overhauled, while about 40% were scrapped with the components, wherever possible, going to a spare parts pool. When a gun mount was overhauled, needed replacement parts were taken, to a very large extent, from this spare parts pool, as well as from the pool of unused indicator-regulators (referred to immediately above).

(4). Many gun mounts sent to Louisville had to have very little work done on them beyond the basic disassembly, cleaning, inspection, replacement of bearings, seals and wiring, reassembly and testing.

(5). There is no sufficient proof that, during the overhauling process, any *new* elements, acquired from others than G.E. or manufactured by the Government, were introduced.

(6). The average cost of refurbishing a gun mount at Louisville was about $100,000. The original cost of manufacturing the gun mount was about $800,000, and the worth to the Navy in terms of the original cost of manufacture plus spare parts in store was about $1,000,000.[14]

From these facts (together with others stated above and in the findings) we draw the conclusion that plaintiff has failed to prove that, in overhauling the accused gun mounts, the Navy used (aside from the guns) any substantial number of components—new or old—obtained from other suppliers than G.E., or manufactured by the Govern-

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The trial judge made no finding on this precise point, and our review of the record shows that, at best, plaintiff has failed to prove that any of the power drive units in the original gun mounts came to the Navy through a source other than G.E.

It is clear that the guns themselves (and accompaniments)—one element—did not come from G.E. but it is unclear whether G.E. supplied the handwheel drive assembly (one element of the patented combination).

[14] Also, the life span of the renovated gun mounts was considerably shorter than of the original mount.

ment itself; on the contrary, the fair inference is that Louisville used either old, refurbished components from the parts of the original gun mounts supplied by G.E., or new indicator-regulators and power drives originally purchased from G.E. and kept in the spare parts pool.[15] It follows that, of the components of the overhauled gun mounts, only the guns (and accompaniments) and possibly the handwheel drive assembly did not come at all from the plaintiff; and even those two elements came from the original gun mounts. As we shall see, these ultimate facts are cardinal to our limited decision in this case.

C. The leading modern case on reconstruction versus repair is *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 365 U.S. 336 (1961), commonly referred to as "*Aro I.*" There, the Supreme Court considered a patent containing claims drawn to a combination for use with an automobile body comprising a flexible top fabric, supporting structures and a mechanism for sealing the fabric against the side of the automobile body to keep out rain.

In reversing the lower court's decision that replacement of the unpatented flexible top fabric in the patented combination amounted to infringing reconstruction, the Court stated, at 344–45, that: "[If] anything is settled in the patent law, it is that the combination patent covers only the totality of the elements in the claim and that no element, separately viewed, is within the grant. * * * The basic fallacy in respondent's position is that it requires the ascribing to one element of the patented combination the status of patented invention in itself."

The Court then summarily disposed of the "heart of the invention" theory of reconstruction reflected in many lower court cases by stating, at 345, that, "No element, not itself separately patented, that constitutes one of the elements of a combination patent is entitled to patent monopoly, however essential it may be to the patented combination, and no matter how costly or difficult replacement may be," and applied the above principle to the

[15] In his opinion, the trial judge described the overhauled gun mounts as consisting of "spare, cannibalized and overhauled components which happened to be available * * *."

reconstruction-repair dichotomy in the following language at 346:

> The decisions of this Court require the conclusion that reconstruction of a patented entity, comprised of unpatented elements, is limited to such a true reconstruction of the entity as to in fact make a new article, * * * after the entity, viewed as a whole, has become spent. * * * Mere replacement of individual unpatented parts, one at a time, whether of the same part repeatedly or different parts successively, is no more than the lawful right of the owner to repair his property. Measured by this test, the replacement of the fabric involved in this case must be characterized as permissible 'repair,' not 'reconstruction.'

Defendant argues strongly that *Aro I* permits a finding of reconstruction (rather than repair) only where *all* elements of the patented combination, including so-called "minimal" elements, are replaced, no single element of the original combination being retained. The trial judge, on the other hand, was apparently willing to find reconstruction (in the circumstances here) even though many or all of the original elements happened to be used again in recreating (as he deemed it) the combination, and such spare parts as were used came from G.E. He thought that there was no specific talisman but that the question of reconstruction *vel non* had to be decided in each instance on the particular facts. In this instance he considered, first, that the original gun mounts had fulfilled their useful lives and were therefore "spent," and, second, that the method of operation at Louisville demonstrated that the Navy was creating a "new article" when it overhauled the original gun mounts—primarily because the original mounts were "spent" and the Navy disassembled the mounts into components and put them back together without taking account of the particular mounts or ships from which the individual components had come.[16]

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[16] In his opinion, the trial judge said:

"[T]he gun mounts which were sent to NOS Louisville were no longer suitable for their intended uses. Due to their inordinate amounts of down time, these 25 to 30-year old gun mounts were no longer reliable and in more than a token sense contributed additional danger to the vessel and its crew in terms of readiness for and actual use in combat conditions. . . . . In sum, these gun mounts had fulfilled their useful lives and were 'spent' as that term has been used by the courts

To dispose of this case we need not tackle the correctness of the Government's strict reading of *Aro I*, nor need we decide if the trial judge's approach would be correct if a substantial number of new components, *not from G.E.*, were introduced by NOS Louisville into the overhauled gun mounts. For this case it is enough, in our view, that, as we have pointed out, the overhauled gun mounts appear to have been refurbished from the components in the original mounts, plus some new indicator-regulators or power drives purchased from the plaintiff itself—and that of the 17 elements (all unpatented) in the patented combination embodied in the original mounts, at least 15 (and possibly 16) came to the Navy from G.E. itself. Thus, except for the gun (and accoutrements), plaintiff must be taken as the source of almost all of the elements making up both the original and the overhauled combination.[17]

In these circumstances it seems to us that the user of the combination (the Navy) was not creating a "new article" in

throughout the last 100 years.

When a gun mount was disassembled into its four basic components . . ., the patented combination ceased to exist. All that remained of the original gun mount was the base ring. Moreover, the separated components were never reunited. . . . [A] new gun mount was being constructed around the base ring from components then available for use. Once the components taken from a gun mount had been overhauled, they then became available for installation on whichever gun mount was being constructed at the time.

"In sum, each gun mount coming out of NOS Louisville was constructed not from its original components, but rather from spare, cannibalized and overhauled components which happened to be available at the time of construction. Moreover, an overhauled gun mount would then be sent to whichever vessel needed it at the time, with no attempt being made to return a gun mount to its original vessel." (footnote omitted)

Later in his opinion the trial judge summarized as follows the significant factors he took into account:

"These factors include the inability of the 5"/38 single Mk 30 gun mounts to perform basic, necessary functions which they were originally meant to perform, the inability of traditional maintenance procedures to bring the gun mounts up to these performance levels, the age of the original gun mounts, the complete disassembly at NOS Louisville and the failure to maintain gun mount integrity between components, the substitution of the next available components from stock or overhaul for all original components removed from the gun mount regardless of whether or not the removed components were individually spent and the failure to return the gun mount to its original vessel." *Id.*

[17] Plaintiff, of course, has the burden of proof on issues relating to infringement (including "reconstruction"). *See Strumskis v. United States*, 200 Ct. Cl. 668, 676–77, 474 F.2d 623, 628, *cert. denied*, 414 U.S. 1067 (1973); *Stamicarbon v. Escambia Chemical Corp.*, 430 F.2d 920, 931, 166 USPQ 362, 371 (5th Cir.), *cert. denied*, 400 U.S. 944 (1970).

the sense of *Aro I*, even though the gun mounts were disassembled in order to be overhauled, and even though, in some or most or all instances, the reassembled elements were not returned to the same gun mount or the same ship. This follows, we think, from the principle grounding compensation for a licensee's using a patented combination composed of unpatented elements. *See Calhoun v. United States*, 197 Ct. Cl. at 52–53, 453 F.2d at 1391–92.[18] When it obtains its license, such a licensee is deemed to have paid full compensation for the privilege of using the combination itself and is not required to pay again merely for using the whole of the combination, even including some replacement from another source of a worn-out, unpatented element. *Id.*

In this case there are two separate (but interlocking) grounds on which the Navy should be held to have already fulfilled its obligation to compensate G.E. for using the combination—as if the United States had specifically paid General Electric for a license. The first is the running of the statute of limitations which frees the United States from all liability at least up to 1963 or 1964, *see* note 11, *supra*, and makes the Government the equivalent of a paid-up licensee for the period barred by limitations.[19] *Cf. United States v. 422,978 Square Ft. of Land, San Francisco*, 445 F.2d 1180, 1187–89 (9th Cir. 1971). This covers the whole combination (including the two elements which plaintiff may not have supplied).

The second and more important ground for saying that the United States has already paid to use the combination—a ground filling any open gaps in the statute of limitations—is that, in the overhaul process, no new components were purchased by the Government from others than G.E. or were made by the Navy itself; almost all the components came from G.E. itself, either through the procurement of the original mounts or in the use for

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[18] *Calhoun*, as we have indicated, holds that the Government must be treated as the equivalent of such a licensee. *See* note 11, *supra*.

[19] The trial judge found that the period of recovery for reconstruction was limited to 1967–1971 (when the patent expired) because the evidence was insufficient to justify conclusions as to the precise nature of the overhaul program during the years 1962–1967. *See* note 12, *supra*. Plaintiff challenges this holding, but we find it unnecessary to pass on it or to decide the exact period barred by limitations.

replacement of new spare parts which had also come from G.E. In paying plaintiff for those components, the defendant impliedly obtained a license to use the combination and compensated G.E. therefor.[20] In addition, it is highly improbable that G.E. could have sold to the defendant 15 out of 17 elements in the combination without implicitly authorizing the latter to use the combination so long as the General Electric-supplied elements were able to be used and were in fact used; and this is true of both the sale by G.E. of the original components of the gun mounts and of the new unused components which were kept as spare parts and incorporated in the overhaul process. *See Stukenborg v. United States*, 178 Ct. Cl. 738, 748, 372 F.2d 498, 504 (1967). Unless there is some definite provision in the sale to the contrary, *see Cotton-Tie Co. v. Simmons*, 106 U.S. 89 (1882), *as explained in Aro I*, 365 U.S. at 343, n.9, it can properly be assumed that as part of the bargain the seller of a device incorporating a patented combination (composed, as here, of unpatented elements) authorizes the buyer to continue to use the device so long as the latter can and does use the elements he purchased from the patentee or licensor.[21]

In this respect the case is very close to *Wilbur-Ellis Co. v. Kuther*, 377 U.S. 422 (1964). Kuther was the owner of a combination patent covering a fish-canning machine; the combination, like the one here, was of unpatented components. He sold four of these machines (at a price including his royalty) to someone else who later resold them to Wilbur-Ellis, as a second-hand purchaser. At that

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[20] "* * * it is fundamental that sale of a patented article by the patentee or under his authority carries with it an 'implied license to use.' " *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 377 U.S. 476, 484 (1964) (*Aro II*).

[21] The principle is not changed because the gun itself (and accompaniments)—one of the 17 elements of the combination—did not come from G.E. Plaintiff, which obviously would not furnish the gun, could not and would not object to transferring one of the patented gun mounts, as a whole, from one gun to another, or to the Navy's replacing only the gun. In any event the decisions are plain that replacement of one or two elements of a many-elemented combination does not constitute reconstruction by a licensed user. *See Aro I*, 365 U.S. at 345–46; *Stukenborg v. United States*, 178 Ct. Cl. at 747, 749, 372 F.2d at 504–05; *Wells Mfg. Corp. v. Littelfuse, Inc.*, 547 F.2d 346, 351, 357, 192 USPQ 256, 260, 265–66 (7th Cir. 1976). Similarly for the handwheel drive assembly (also one element) if plaintiff is taken as not having supplied that element.

time, three of the machines had been unused for some years, "exposed to rain and salt air, corroded and frozen solid to the extent that they were inoperable when acquired by Wilbur Ellis"; they were "apparently regarded as 'junk' " *Kuther v. Leuschner*, 200 F.Supp. 841, 844 (N.D. Cal. 1961), *aff'd*, 314 F.2d 71 (9th Cir. 1963), *rev'd sub nom. Wilbur-Ellis Co. v. Kuther*, 377 U.S. 422 (1964). Originally the machines were constructed to pack fish into one-pound cans. Wilbur-Ellis had the machines reconditioned to operable condition and also had six of the 35 elements of the patented combination resized so that the machines could pack 5-ounce cans. The Supreme Court held that this reconditioning was more like repair than reconstruction. Stressing that the patentee, in selling the machines, had already received compensation for the use of the combination, *see* 377 U.S. at 423, 425, Mr. Justice Douglas's opinion for the Court saw no "reconstruction" because, although Wilbur-Ellis "in adapting the old machines to a related use were doing more than repair in the customary sense * * * what they [Wilbur-Ellis] did was kin to repair for it bore on the useful capacity of the old combination * * *." *Id.* at 425. It made no difference that the machines were inoperable when Wilbur-Ellis acquired them or that "the adaptation made in the six nonpatented elements improved the usefulness of the machines." *Id.* at 423, 424, 425.[22]

The old gun mounts in the present case were no more completely "spent", as a whole, than the fish-canning machines in *Wilbur-Ellis;* the 60% which the Navy chose to renovate (and did not cannibalize) must be considered to have "had years of usefulness remaining though they needed cleaning and repair." *Id.* at 424. Indeed, this case is, in one sense, *a fortiori* from *Wilbur-Ellis* in that there was no effort to adapt the mounts to different uses. Of special relevance, therefore, is the statement in *Wilbur-Ellis, see* note 22, *supra,* that if those machines had been renovated and put to use with their original adaptability (one-pound

[22] The Court said, "These four machines were not spent; they had years of usefulness remaining though they needed cleaning and repair. Had they been renovated and put to use in the '1-pound' cans, there could be no question but that they were 'repaired,' not 'reconstructed,' within the meaning of the cases." 377 U.S. at 424.

cans), "there could be no question but that they were 'repaired,' not 'reconstructed,' within the meaning of the cases."[23]

The trial judge thought the same result not mandated here primarily because of "the complete disassembly at NOS Louisville and the failure to maintain gun mount integrity between components, the substitution of the next available components from stock or overhaul for all original components removed from the gun mount regardless of whether or not the removed components were individually spent and the failure to return the gun mount to its original vessel," *See* note 16, *supra*. We do not think that these factors call for a different conclusion than in *Wilbur-Ellis*. The assembly-line method adopted at Louisville was simply a speedier, less expensive, more efficient, and more effective means of refurbishing the gun mounts than if they had been disassembled and renovated gun mount by individual gun mount, and then returned to the same ship—and the end-result was precisely the same. Disassembly and renovation by individual gun mount would surely not be enough to show reconstruction—or *Wilbur-Ellis* could not have been decided as it was—but it would have been a much more burdensome, time-consuming, and costly procedure. Achieving precisely the same result by a more practical, economical and convenient process is surely not required by the patent law in order to avoid imposition of further liability. The substance of what was done to the mounts would be the same by either method, the difference being simply that the procedure followed by the Navy at Louisville was easier, quicker and less expensive. *Cf. Electric Auto-Lite Co. v. P & D Mfg. Co.*, 109 F.2d 566, 567, 44 USPQ 377, 379 (2d Cir. 1940).[24] If it is permissible, as it is, to introduce wholly new components, acquired from another supplier, into the renovation of a

[23] In *Wilbur-Ellis*, it is worth noting, to renovate the machines in order to retain one-pound capacity would have required complete replacement of six elements which were too rusted or corroded to use again for that purpose. *See Leuschner v. Kuther*, 314 F.2d 71, 72–73 (9th Cir. 1963) (the Court of Appeals decision reversed by the Supreme Court).

[24] It should be recalled that "many gun mounts had to have very little work done on them beyond the basic disassembly, cleaning, inspection, replacement of bearings, seals and wiring, reassembly and testing" (finding 282).

device embodying a patented combination, *see* notes 21 and 23, *supra*, it is very hard to say that the assembly-line method followed at Louisville amounted to reconstruction when the record indicates that in the overhauling process the Navy worked with, substantially, all G.E.-supplied elements and did not introduce new elements acquired from others than plaintiff.

For these reasons we hold that the defendant had a right to overhaul the gun mounts without paying any further compensation to the plaintiff. There was no infringement through the NOS Louisville overhaul program even though claim 8 of the Kane patent has been upheld as valid in Part I, *supra*. Since there was no infringement, plaintiff can recover nothing in this suit and the petition must be dismissed.

CONCLUSION OF LAW

Upon the findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiff is not entitled to recover and the petition is dismissed.

JAMES R. GRIFFIN, JR. v. THE UNITED STATES

[No. 178–77. Decided February 22, 1978]

ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

Military awards for suggestions; Court of Claims jurisdiction; implied contract.—Plaintiff seeks an increase in the amount of a cash award he received under 10 U.S.C. § 1124 for a meritorious suggestion relating to Minuteman Missile silos. It is *held* that the court has jurisdiction over the claim as one based on a contract implied in fact. While the Service Secretary may have originally had uncontrolled and unreviewable award discretion, since he published procedures and guidelines, received responsive suggestions and implemented them, and passed upon compensation claims, he surrendered some of his discretion and the legal possibility of abuse of discretion arose. Plaintiff's suggestion having been accepted and acted upon, an implied contract resulted. It is also *held* that Sec. 1124(d)(1) does not bar plaintiff from

receiving additional compensation if justified. Since the parties are in dispute as to the correctness of the calculation of the award and since this issue cannot be determined on summary judgment, the case is remanded to the trial division for further proceedings, defendant's motion for summary judgment being denied.

Statutes; construction and operation; judicial interpretation; generally.

[1] Decisions construing a statute respecting civilian personnel and serving as a model for analogous military legislation, are relevant in construing the latter.

Armed Services ⚖2

Court of Claims jurisdiction; generally.

[2] One who files suit in this court under the Tucker Act must show a clear-cut entitlement to monetary relief under law apart from the Tucker Act, the latter simply waiving sovereign immunity and providing the forum for adjudication.

Federal Courts ⚖1071

Contracts; implied contracts; implied in fact; awards for suggestions.

[3] The Tucker Act recognizes contracts implied in fact, as fully as if they were express. Where plaintiff's suggestion submitted pursuant to 10 U.S.C. § 1124 and published procedures and guidelines relating to evaluation, implementation and compensation, was adopted by the Secretary to the great benefit of the Service, and an award was made to plaintiff, an implied contract came into effect binding the Secretary to establish plaintiff's compensation without abuse of discretion and within the guidelines.

Federal Courts ⚖1077

Military pay; awards for suggestions; acceptance of award; estoppel.

[4] That plaintiff accepted a cash award under 10 U.S.C. § 1124 for a suggestion he submitted to the Service, does not mean that he is barred by Sec. 1124(d)(1) from seeking additional compensation within the statutory ceiling. The prohibition to more compensation after award acceptance does not apply to incentive awards.

Armed Services ⚖23.1(2)

Robinson O. Everett, Attorney of Record for plaintiff. *Donnie Hoover,* with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, KASHIWA, and KUNZIG, *Judges.*

PER CURIAM: The plaintiff, an officer in the United States Air Force, received an award under 10 U.S.C. § 1124 for a meritorious suggestion, namely the use of periscopes

for certain purposes in the Minuteman missile silos. He contends that the award is insufficient, and in arriving at the amount thereof, aggregating $8,905, the Air Force has been arbitrary and capricious, and has failed to follow its own regulations, according to him. Defendant moves for summary judgment, but we conclude that there are issues of fact requiring trial.

Defendant's first point is that making any such award is discretionary, and therefore any claim for one, or an increase in one, fails to pass the analysis prescribed by the Supreme Court in *United States* v. *Testan,* 424 U.S. 392 (1976).

The statute, § 1124, *supra,* was intended to extend to servicemen, with limitations not here relevant, the eligibility to receive cash awards for valuable suggestions, made to and adopted by their agencies, that civilian Government employees had long enjoyed under the statute formerly codified as 5 U.S.C. § 2121 and *ff.,* but now § 4503. See legislative history at 2 *U.S. Code Congressional and Administrative News* (1965) p. 3161 and ff. The older statute thus having been the model, decisions under it are relevant in construing the newer one. Claims under the old one have been before this court several times, and it has been generally assumed that the standard for judicial review is abuse of discretion. *Shaller* v. *United States,* 202 Ct. Cl. 571, *cert. denied,* 414 U.S. 1092 (1973); *Serbin* v. *United States,* 168 Ct. Cl. 934 (1964); and *Martilla* v. *United States,* 118 Ct. Cl. 177 (1950). *Kempinski* v. *United States,* 164 Ct. Cl. 451, *cert. denied,* 377 U.S. 981 (1964), can be read as a flat denial of jurisdiction, but there the employee's suggestion was rejected, while here it was adopted and put in effect, a distinction of significance as we will show. In all these cases the court was not persuaded that discretion was abused, a fact which detracts from the authority the cases might otherwise have as to jurisdiction; indeed, in *Martilla* the court expressly passed over, at 118 Ct. Cl. 182, whether it could ever have jurisdiction of such a claim. Defendant's instant motion severs the question of jurisdiction from the merits, and requires us to decide it before addressing the merits.

By the *Testan* analysis, the plaintiff in this court under the Tucker Act, 28 U.S.C. § 1491, must show a clear-cut entitlement to monetary relief, under law apart from the Tucker Act, the latter simply waiving sovereign immunity and providing the forum for adjudication. It may be conceded, *arguendo,* as defendant asserts, that a claim, the allowance of which is wholly discretionary with an executive official, cannot be the subject of a Tucker Act suit. *Grismac Corp.* v. *United States,* 214 Ct. Cl. 39, 48, 556 F.2d 494, 499 (1977), construing 50 U.S.C. § 1431–1435. *Testan, supra,* reversed a decision of this court construed to hold the contrary. But there is a lot more to the instant claim than that.

The Tucker Act recognizes contracts implied in fact, as fully as if they were express. Such contracts have had a major role in our jurisprudence from early days. Before enactment of the present 28 U.S.C. § 1498, the court rejected patent infringement claims in general as sounding in tort. *Schillinger* v. *United States,* 24 Ct. Cl. 278 (1889), *aff'd,* 155 U.S. 163 (1894). But it allowed suits on patent claims on an implied contract theory, if the inventor offered the invention to the Government, expecting it to be tried, and the Government used it, expecting to be called on to pay. *Berdan Fire-Arms Mfg. Co.* v. *United States,* 25 Ct. Cl. 355 (1890), 26 Ct. Cl. 48 (1890), *aff'd,* 156 U.S. 552 (1895). More recently, this court has applied similar implied contract reasoning where a claimant had submitted an unpatented design in confidence, and defendant circulated it to all its other competing vendors. *Padbloc Co.* v. *United States,* 161 Ct. Cl. 369 (1963). A claim not unlike *Padbloc's* was made in *Grismac, supra,* but foundered because the alleged intellectual property there was considered a mere outsider's suggestion, which defendant's officials had not been given authority to use appropriated funds to buy. *Padbloc* was distinguished by pointing to 10 U.S.C. § 2386, which plainly authorized purchase of the designs Padbloc had submitted. It was also pointed out that under 5 U.S.C. § 4503, suggestions by defendant's employees fared the same as designs.

Here, following enactment of the statute, which in effect authorized purchase of suggestions from service members,

the following events took place: (1) The Secretary of the Air Force published a procedure, Air Force Manual 900–4, February 1970 (Defendant's Exhibit 2) by which a serviceman could submit a suggestion, it would be evaluated, and if adopted would be implemented, and his compensation would be determined according to procedures and guidelines set forth in the manual. (2) Plaintiff, a serviceman, submitted a suggestion. (3) It was adopted and put in effect to the great benefit of the Air Force, allegedly a saving of $45,000,000. (4) Plaintiff's claim for compensation was considered and an award made.

We can put aside a case, as in *Kempinski, supra,* where the suggestion was rejected. Here it was accepted and acted on. We think clearly, under authority of *Berdan* and *Padbloc,* at the end of step 3, the Secretary had become bound by an implied contract. Its terms, at a minimum, required him to establish plaintiff's compensation without abuse of discretion and within the guidelines he had published, if there be any difference between these two concepts.

Besides the *Berdan* and *Padbloc* cases, the situation also offers some parallels to the implied contract rights we have imputed to one who has submitted an unsuccessful bid in response to a Government advertisement for bids. *Heyer Products Co.* v. *United States,* 135 Ct. Cl. 63, 140 F.Supp. 409 (1956); *Keco Industries, Inc.* v. *United States,* 192 Ct. Cl. 773, 428 F.2d 1233 (1970) and their progeny. We think plaintiff's case is stronger because he is plainly the intended beneficiary of 10 U.S.C. § 1124 while that is not so certain as to the unsuccessful bidder.

Thus, we think that the Secretary may have originally had uncontrolled and unreviewable discretion in the premises, but as he published procedures and guidelines, as he received responsive suggestions, as he implemented them and through his subordinates passed upon compensation claims, we think by his choices he surrendered some of his discretion, and the legal possibility of abuse of discretion came into the picture. Defendant seems to concede the rightness of this analysis at page 4 of its reply brief when it says: "However, once the Secretary decides in his discretion to make an award, the appropriate regula-

tions must be followed, as plaintiff contends, and the failure to do so might well provide a cause of action for the individual concerned." At some point plaintiff acquired a legal entitlement by implied contract, more than just the hope or expectation which was all he had originally. As under many other implied contract situations, what remained for adjudication was quantum.

Some further issues may be disposed of more quickly. Defendant says plaintiff, having accepted $8,905, is barred from claiming more by § 1124(d)(1) of the statute, which provides that the acceptance of an award shall constitute

> (1) an agreement by the member that the use by the United States of any idea, method, or device for which the award is made may not be the basis of a claim against the United States by the member, his heirs, or assigns * * *.

Plaintiff argues that this means claims for compensation other than by incentive award. The legislative history seems to support this view as it gives, to illustrate what is meant, the case of an employee patenting his invention and claiming royalties under the patent. 2 *U.S. Code Congressional and Administrative News* (1965), *supra*, at 3164. Moreover, defendant has not in administration of the Act taken the position it does here. Thus plaintiff did not get his $8,905 all at once, but in driblets, and acceptance of one driblet was not taken as barring payment of the next one. If Congress had meant that acceptance of any incentive payment should bar any claim for additional incentive award, it could have said so. Should the Secretary desire, he could no doubt change the procedures so that a paid claimant would know and agree that this would occur. The Secretary could learn from any insurance company, or anyone else in the business of settling claims, how to do it. Instead, we see him actually suggesting in AFM–900–4, par. 5–3a(3), that an initial cash award not to exceed $50 be paid when delays are foreseen in determining the full value of an adopted contribution, but it is reasonably certain it will be over $500. We may be sure he does not intend this as a trap for claimants.

For tangible benefits, awards are payable on a sliding scale and for those over $100,000, the scale allows only $5

for each $5,000 of benefits. The benefits can be only those which inure in the first year of operation. Defendant's final retreat argument is that the total of $8,905 is correctly calculated in view of these provisions. The plaintiff denies it, saying that the benefits were $45,000,000, that there was a question when the first year of operation might be said to begin, etc., etc. It may be possible on pretrial to establish that there is no real triable issue of fact, but we are unable to do it just by looking at the motion and opposition and documents attached. It is not likely to be feasible to make a disputed quantum determination on summary judgment, and we decline to attempt it here. Plaintiff does not attack the regulation, but only says that if correctly applied, it would support his position. Defendant says if the administrative interpretation of the regulation is reasonable, we must accept it even if we think some other interpretation is more reasonable. We leave this to the Trial Division to pass on.[1]

Accordingly, defendant's motion for summary judgment is denied and the cause is remanded to the Trial Division for further proceedings.

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572 F.2d 786

SUN OIL COMPANY, THE SUPERIOR OIL COMPANY AND MARATHON OIL COMPANY v. THE UNITED STATES

[No. 806–71. Decided February 22, 1978]

ON THE PROOFS

Contracts; lease; delay claims; breach of contract; taking; Outer Continental Shelf Lands Act.—This is an action by three oil companies seeking to recover damages and/or just compensation emanating from an oil and gas lease which plaintiffs, as a group, obtained from the Interior Department on April 1, 1968. Interior granted the lease on the authority of the Outer Continental Shelf Lands Act, the lease granting plaintiffs the exclusive right to drill for, remove and dispose of all oil and gas deposits from Tract 401, embracing the

[1] The statute, 10 U.S.C. § 1124(f), places a $25,000 limit on an incentive award, and plaintiff's further recovery, if any, would be limited by that ceiling.

Syllabus

major oil and gas fields, in the Santa Barbara Channel. Plaintiffs' claims center on their efforts to construct two oil drilling platforms on Tract 401, namely Platform Hillhouse to be located on the west side of Tract 401 and Platform Henry to be located on the east side thereof. Respecting Platform Hillhouse, the essence of plaintiffs' claims is that defendant unreasonably delayed them (189 days) in their efforts to install the platform and to drill for and produce oil and gas therefrom. Platform Hillhouse was eventually installed. Respecting Platform Henry, plaintiffs contend that defendant's refusal to approve their application to install the platform constituted a breach of the lease contract entitling them to resulting damages. Plaintiffs also argue that defendant's actions relative to this platform resulted in a taking of their leasehold rights entitling them to just compensation under the Fifth Amendment. Plaintiffs have not as of the date proof was closed produced any oil or gas from the east side of the tract. Defendant disclaims any unreasonable delay, interference or improper actions. For the reasons set forth, it is *held* that defendant did not breach the lease contract relative to installation and operation of Platform Hillhouse. It is also *held* that defendant breached the lease agreement with respect to denial of plaintiffs' application for installation of Platform Henry. It is further *held* that defendant's actions as to Platform Henry did not constitute a taking, in whole or in part, of plaintiffs' leasehold. Plaintiffs' petitions respecting Platform Hillhouse claims are dismissed. Judgment is entered for plaintiffs respecting the Platform Henry breach claim, and the amount of recovery will be determined under Rule 131(c). The petitions setting forth an alternative taking theory of recovery are dismissed.

Contracts; lease; Outer Continental Shelf Lands Act; generally.

[1] The Outer Continental Shelf Lands Act provides, *inter alia*, for Federal jurisdiction over submerged lands on the Continental Shelf situated beyond the 3-mile coastline limit. A lease issued under the Act does not convey title in the lands nor does it convey an unencumbered estate in the oil and gas; a lease conveys a property interest enforceable against the Government, but such interest lacks many of the attributes of private property.

Mines and Minerals ⚖5.1(5)

Contracts; lease; Outer Continental Shelf Lands Act; congressional intent.

[2] In enacting the Outer Continental Shelf Lands Act, Congress intended to exercise both proprietary powers of a landowner and the police powers of a legislature in regulating leases of publicly owned resources.

Mines and Minerals ⚖5.1(5)

Contracts; breach; prevention or hindrance of performance by other party; generally.

[3] It is an implied condition of every contract with the Government that neither party will do anything to prevent, hinder or delay contract performance.

United States ⚖70(34)

Syllabus

Contracts; damages; delay caused by Government.

[4] The Government must respond by way of breach of contract damages if it unreasonably delays a lessee in contract performance or if it unjustifiably prevents a lessee from performing under its contract.

Mines and Minerals ⚖5.1(5)

Contracts; lease; Outer Continental Shelf Lands Act; actions of Secretary of Interior.

[5] In determining whether the actions of the Secretary were unreasonable and unjustified respecting the delays encountered by plaintiff relative to issuance of the lease and installation of platforms to drill for, remove and dispose of oil and gas deposits lying within the leasehold, the circumstances relative to issuance of the lease, the milieu in which lease performance was to take place, and the environmental concern implicit in the totality of the Federal leasing program on the Outer Continental Shelf Lands Act must be considered, as well as the obligations, duties and responsibilities placed on the Secretary by the Act. Under such circumstances, the lessee's rights are not absolute and unqualified.

Mines and Minerals ⚖5.1(5)

Federal Register; documents required to be published; notice.

[6] Where the Secretary withdrew the Regional Supervisor's authority to act as his representative relative to lease activities on the Outer Continental Shelf Lands Act and required his personal approval of any plan of development and installation permit under such leases, the fact that notice of his action was not published in the Federal Register does not impair the validity thereof as to persons who have had actual notice.

Mines and Minerals ⚖5.1(5)

Contracts; delays; reasonable v. unreasonable Government delay.

[7] What is a reasonable period of time for the Government to do a particular act under the contract is entirely dependent upon the circumstances of the particular case.

Mines and Minerals ⚖70(34)

Contracts; lease; Outer Continental Shelf Lands Act; administration of leasing; duties of Secretary of Interior.

[8] Under 43 U.S.C. § 1334(a)(1), the Secretary is responsible for the administration of Outer Continental Shelf Lands Act leases and is under a duty to protect the environment against waste and to conserve natural resources. These responsibilities and duties cannot be lightly assumed by the Secretary.

Mines and Minerals ⚖5.1(5)

Presumptions; official actions of Government officials; presumption of regularity.

[9] There is a presumption that public officials perform their duties in a proper manner.

Evidence ⚖83(1)

Syllabus

Contracts; delay; reasonable Government delay.

[10] The period from April 26 to August 15, 1969 for the Interior Department and the Secretary to process, review, approve and issue plaintiffs' application of development and permit for construction and installation of Platform Hillhouse was not an unreasonable period under the circumstances of the blow out adjacent plaintiffs' leasehold, the drilling of wells by another lessee to relieve pressure pursuant to a recommendation of an investigative committee, plaintiffs' review of their plan at defendant's request in view of the blow out, further administrative review after plan revision, review of the plan by the Secretary upon completion of the drilling, and performance by plaintiffs of a surface survey for bubbles at defendant's request to ensure that additional drilling by plaintiffs could be done safely, taking into consideration that the blow out involved severe and extensive environmental damage to the Channel and coastal area. Defendant's actions reflect a prudent and cautious effort to protect the environment from risk of harm.

Mines and Minerals ⇐5.1(5)

Contracts; suspension of work; reasonableness of suspension by contractor.

[11] It was not reasonable for plaintiffs to suspend construction of Platform Hillhouse pending approval of their plan and permit, where, having authorized construction before their plan and permit submissions, they were not motivated by approval considerations, platform construction was not dependent on approval, the lease agreement or regulations did not require prior platform construction approval, under the lease plaintiffs had a vested right to install a platform, defendant did not order plaintiffs to suspend the construction, and the platform contractor, in view of the possibility of installation delay, recommended against the suspension. Thus the absence of the platform renders any delay in plan and permit approval of little or no significance since such delay would not delay the ultimate completion of the project.

Mines and Minerals ⇐5.1(5)

Public lands; mines and minerals lease; Outer Continental Shelf lands; dual responsibility of Government agencies.

[12] Agreements between the Army Corps of Engineers and the Interior Department as to their dual responsibilities for navigation and national security aspects of permit authorization and for environmental and other matters, respectively, in the issuance of oil and gas leases in the Outer Continental Shelf areas, while not required by the Outer Continental Shelf Lands Act are not proscribed thereby. Such agreements avoid duplication of effort and avoid uncertainty as to clearance responsibility and duty.

Mines and Minerals ⇐5.1(5)

Contracts; delay; reasonable Government delay.

[13] In view of the duty imposed on the Secretary to protect the Channel environment during the course of the Federal lease program, of plaintiffs' plan of development indicating that they would not

commence drilling until a pipeline to shore was available in order to relieve unexpected pressure encountered during drilling, and of the refusal of the California State Lands Commission to act on plaintiffs' request to construct a pipeline across state lands within the 3-mile limit, it was not unreasonable for the Secretary to investigate possible pressure reactions and environmental hazards before allowing plaintiffs to drill without available pipeline facilities.

Mines and Minerals ⚖5.1(5)

Contracts; delays; reasonable Government delays.

[14] Where, although plaintiffs were ready to produce oil and gas, they had no pipeline facilities to shore of their own because California refused to permit construction thereof, and although Union Oil agreed to assign to plaintiffs part of its pipeline to shore facilities contingent on state approval of the assignment (not initially forthcoming), and where the Secretary in deference to California and within his discretionary authority, pursuant to Sec. 2(c) of the subject lease, initially refused to issue a directive to Union Oil compelling it to carry plaintiffs' production through the pipeline, the 35 days, spent by Interior and the Secretary in making a good faith effort to resolve the matter and Interior's activities in persuading California to approve the assignment, did not constitute unreasonable or unjustified delay chargeable to the Government.

Mines and Minerals ⚖5.1(5)

Environment; protection; environmental impact statement.

[15] The National Environmental Policy Act of 1969 is an environmental full disclosure law which seeks to assure that potential environmental impacts are subject to thorough study and a detailed statement.

Health and Environment ⚖25.10

Administrative practice and procedure; separation of administrative and other views; political considerations.

[16] While denial by the Secretary of plaintiffs' permit application to install an oil drilling platform would be invalid if based on political influence from the White House, given the public interest in and concern about the environment in the Santa Barbara Channel, the seeking of guidance by a cabinet officer who was not disposed to grant the permit does not demonstrate that political considerations motivated the denial, absent reliable evidence to the contrary.

Mines and Minerals ⚖5.1(5)

Contracts; lease; Outer Continental Shelf Lands Act; administration of leasing; authority and duties of Secretary of Interior.

[17] Although the Secretary has broad powers and considerable authority to control Outer Continental Shelf Lands Act lease operations in the Channel area, that power and authority is not absolute. He has a duty and responsibility to protect the Channel environment, but he cannot breach vested contractual rights under the guise of protecting the environment if the exercise of those rights pose no threat to the environment.

Mines and Minerals ⚖5.1(5)

Syllabus

Contracts; lease; Outer Continental Shelf Lands Act; lessee's rights and obligations.

[18] Lessees of areas in the outer continental shelf oil fields do not have an absolute right under the lease to conduct oil drilling operations when, where and how they please; they are subject to reasonable restraints on their lease rights when such restraints are based on sound environmental and/or conservation grounds.

Mines and Minerals ⚖5.1(5)

Public lands; mines and minerals lease; Outer Continental Shelf Lands Act; administration of leasing; authority and duties of Secretary of Interior; retroactivity of regulation.

[19] Since Sec. 5(a)(1) of the Outer Continental Shelf Lands Act empowered the Secretary to amend existing rules and regulations whenever he deemed it necessary for conservation of natural resources, regulations adopted after the subject lease was entered into are binding on the parties.

Mines and Minerals ⚖5.1(5)

Contracts; breach; lease of Outer Continental Shelf lands; denial of permit to install platform.

[20] Where plaintiffs' plan of development of their leasehold in Tract 401 and their permit application to install Platform Henry complied with all applicable rules, regulations and orders under the Outer Continental Shelf Lands Act, where all officials subordinate to the Interior Secretary recommended grant of the installation permit, and where the 1971 Final Environmental Statement found not only that the platform was required in order to complete development of the field but rather there was no conservation, environmental or other impediment to the granting of the permit, the Secretary's denial of the permit as posing a threat of harm to the environment was neither authorized nor justified by the Act and implementing regulations, and was an interference with and breach of plaintiffs' lease right to install the platform.

Mines and Minerals ⚖5.1(5)

Administrative practice and procedure; Secretary of the Interior; decision of Secretary; subsequent explanation.

[21] A supplementary explanation wherein the Secretary listed the primary factors that led to his prior decision denying plaintiffs' application for permit to install an oil drilling platform is, to some extent, a *post hoc* rationalization and thus must be viewed critically. To the extent that the Secretary in denying plaintiffs' application relied on factors which were known and undoubtedly considered when the lease was executed or as to which there is no evidence indicating environmental risks unanticipated at the time the lease was executed, the factors must be considered unjustified and unreasonable.

Mines and Minerals ⚖5.1(5)

Contracts; sovereign act doctrine; applicability.

[22] The United States when sued as a contractor or lessor cannot be held liable where the action complained of had public and general

applicability. However, where the action of the Secretary of the Interior in denying the Platform Henry installation permit was not an action of public and general applicability, but was directed principally and primarily at plaintiffs' contractual right, the doctrine of sovereign immunity does not insulate defendant from liability.

United States ⚖125(16)

Eminent domain; taking; partial taking.

[23] Partial takings are not strange animals in the law of Federal eminent domain.

Eminent Domain ⚖96

Claims against the United States; alternative claims; extent of recovery.

[24] Where plaintiffs presented alternative theories of recovery for denial of their permit to install Platform Henry, namely breach of contract and taking, recovery on one theory precludes recovery on the other.

Election of Remedies ⚖3(1)

Eminent domain; property interest or right subject to taking; leasehold interest.

[25] A leasehold interest is property, the taking of which entitles the leaseholder to just compensation for the value thereof.

Eminent Domain ⚖82

Eminent domain; taking; temporary taking.

[26] The fact that a taking is temporary, as contrasted with a permanent taking, is of no consequence in the law of Federal eminent domain.

Eminent Domain ⚖114

Eminent domain; taking; regulations as a taking.

[27] Eminent domain (taking of property) is to be distinguished from police power (regulation of property). However, if regulation is unreasonable or arbitrary relative to private property rights, the law of eminent domain applies.

Eminent Domain ⚖2(1)

Eminent domain; taking; generally.

[28] Not every deprivation of use, possession, or control of property is a taking. One must look to the character and extent of any interference with property rights whenever a taking claim is asserted.

Eminent Domain ⚖2(1)

Eminent domain; taking; contractual rights.

[29] The concept of a taking as a compensable claim theory has limited application to the relative rights of party litigants when those rights have been voluntarily created by contract. In such instances, interference with such contractual rights generally gives rise to a breach claim not a taking claim.

Eminent Domain ⚖2(1)

Per Curiam

Sovereign act; effect of on rights and liabilities of parties.

[30] When the United States comes down from its position of sovereignty and enters the domain of commerce, it submits itself to the same laws that govern individuals. Thus, defendant's lease operations in the Channel represent activity by it in a proprietary capacity rather than a sovereign capacity, and, accordingly, under the lease contract with plaintiffs, defendant obtained certain rights and incurred certain responsibilities as did plaintiffs. Remedies for violation of any of plaintiffs' lease rights must be directed at defendant in its proprietary capacity and not in its sovereign capacity.

Mines and Minerals ⇐5.1(9)

Eminent domain; taking; intent to take; necessity for showing.

[31] Before a taking can be established, it must be clear that there was an intent by the United States to take private property. Such an intent can be implied from the facts.

Eminent Domain ⇐295

Eminent domain; taking; authority of Government agent.

[32] Actions of Government representatives on which a taking claim is premised must be authorized, either expressly or by necessary implication, by some valid enactment of Congress. Under the facts of this case, interference by Congress, and not the Secretary, with plaintiffs' contractual rights is a necessary predicate for finding a valid taking claim.

Eminent Domain ⇐2(1)

Henry P. Sailer, attorney of record for Sun Oil Company. *Theodore L. Garrett, Covington & Burling,* of counsel.

Edgar H. Brenner, attorney of record for The Superior Oil Company. *Abe Krash, James A. Dobkin, David Bonderman, Arnold & Porter, Willard B. Wagner, Jr.* and *R. W. Dye,* of counsel.

Richard A. Baenen, attorney of record for Marathon Oil Company. *Patricia L. Brown* and *Wilkinson, Cragun & Barker,* of counsel.

Myles E. Flint, with whom was *Assistant Attorney General James M. Moorman,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

PER CURIAM: This case comes before the court on plaintiff's motion, filed November 7, 1977, moving that the court adopt, as the basis for its judgment in this case, the recommended decision of Trial Judge Thomas J. Lydon,

filed July 15, 1977, pursuant to Rule 134(h), on liability, defendant having failed to file exceptions thereto within the time provided therefor and having by letter of November 1, 1977, informed the trial judge that it would not file exceptions. Upon consideration thereof, without oral argument, since the court agrees with the trial judge's recommended decision, as hereinafter set forth,* it hereby grants plaintiffs' motion and adopts the said decision as the basis for its judgment in this case. Therefore, the court concludes as a matter of law that plaintiffs are not entitled to any recovery relative to the installation of Platform Hillhouse on the west side of Tract 401 under their lease with defendant and their petitions in this regard are dismissed. The court further concludes as a matter of law that plaintiffs are entitled to recover damages for defendant's breach of plaintiffs' lease rights relative to installation of Platform Henry on the east side of Tract 401, and judgment is entered for plaintiffs to that effect, with the determination of the exact amount of recovery to be made in further proceedings under Rule 131(c). Plaintiffs' petitions setting forth an alternative taking theory of recovery relative to installation of Platform Henry are accordingly dismissed.

OPINION OF TRIAL JUDGE

LYDON, *Trial Judge:* This is an action by three major oil companies seeking to recover damages and/or just compensation emanating from an oil and gas lease which the companies, as a group, obtained from the Department of the Interior (Interior) on April 1, 1968. Interior granted the lease on the authority of the Outer Continental Shelf Lands Act, 67 Stat. 462 (1953), 43 U.S.C. § 1331–43 (1970). Under the lease, plaintiffs paid $38,380,032 for the exclusive right to drill for, remove and dispose of all oil and gas (hydrocarbons) deposits from lease Tract OCS–P–0240 (known as Tract 401) in the Santa Barbara Channel off the coast of California. Tract 401 was located on the Outer

* Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed July 15, 1977, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

Continental Shelf Lands (OCSL) approximately 7½ miles southeast of the City of Santa Barbara.

Tract 401 embraced two major oil and gas fields, the Dos Cuadras field and the Carpinteria field. Plaintiffs' claims herein center on their efforts to construct two platforms on Tract 401 in order to drill for, remove and dispose of oil and gas deposits lying within said tract. In the Dos Cuadras field, the concern focuses on Platform Hillhouse, which was located on the west side of Tract 401; in the Carpinteria field, attention settles on Platform Henry, which was to be located on the east side of Tract 401.

As to Platform Hillhouse, the essence of plaintiffs' claim is that defendant unreasonably delayed plaintiffs in their efforts to install Platform Hillhouse on Tract 401 and to drill for and produce oil and gas from said platform. Plaintiffs aver that this breach of lease contract by defendant was responsible for 189 days of delay and seek to recover attendant damages.[1] Platform Hillhouse was installed on Tract 401 and did produce oil and gas from the Dos Cuadras field. As to Platform Henry, plaintiffs contend that defendant's refusal to approve their application to install Platform Henry on Tract 401 constituted a breach of the lease contract entitling them to resulting damages. Further, plaintiffs maintain that defendant's actions relative to Platform Henry resulted in a taking of their leasehold rights, in whole or in part, entitling them to a just compensation award under the Fifth Amendment to the United States Constitution. Plaintiffs have not as of the date proof was closed in this case produced any oil or gas from the Carpinteria field on Tract 401.

Defendant disclaims any unreasonable delay, interference or improper actions relative to installation of and production of gas and oil from Platform Hillhouse. As to Platform Henry, defendant asserts that the actions of the Secretary of the Interior (hereinafter Secretary) relative thereto were legal, proper and justified. Further, in response to plaintiffs' taking claim, defendant advances the view that, in fact, no taking occurred; and that, in any

[1] The parties agreed, and a trial judge so ordered, that the issues of liability and damages be severed, with the matter of quantum, if any, reserved for determination subsequent to resolution of the liability issues.

event, the Secretary had no legal authority to effect a taking, in whole or in part, of plaintiffs' leasehold.[2]

For reasons set forth herein, it is concluded that defendant did not breach the lease contract relative to the installation and operation of Platform Hillhouse. It is my opinion, however, that defendant did breach the lease agreement with respect to denial of plaintiffs' application for installation of Platform Henry. It is also my opinion that, in any event, defendant's actions as to Platform Henry did not constitute a taking, in whole or in part, of plaintiffs' leasehold.

I

- A -

The OCSL Act came into being in 1953. This Act provided, *inter alia*, for federal jurisdiction over submerged lands on the Continental Shelf which were beyond the 3-mile limit from the coastline.[3] *See United States* v. *California*, 381 U.S. 139 (1965) and 382 U.S. 448 (1966).

Section 8 of the OCSL Act, 43 U.S.C. § 1337(a), authorized the Secretary to grant oil and gas leases on OCSL by competitive bidding. In *Union Oil Company of California* v. *Morton*, 512 F.2d 743, 747 (9th Cir. 1975), it was stated that:

> * * * A lease issued under this Act [OCSL Act], like a mineral lease granted under the Mineral Leasing Act of 1920, 30 U.S.C. § 181 et seq., does not convey title in the land, nor does it convey an unencumbered estate in the oil and gas. *See Boesche* v. *Udall*, 373 U.S. 472, 478, 83 S.Ct. 1373, 10 L.Ed. 2d 491 (1963); *McKenna* v. *Wallis*, 344 F.2d 432, 440–41 (5th Cir. 1965), vacated, 384 U.S. 63, 86 S.Ct. 1301, 16 L.Ed2d 369 (1966). The lease does

[2] The parties elected to present this litigation to the court on a stipulation of facts, accompanied by a large number of documentary exhibits. Neither party wanted a trial. These decisions by the parties were made after each side had engaged in exhaustive pretrial discovery. In retrospect, the absence of testimonial evidence has inhibited, to some degree, the ability of the trier of fact to make more definitive findings in certain areas where the parties proffer different conclusions based on the same stipulated facts. See in this regard *Kramer* v. *United States*, 186 Ct. Cl. 684, 691–93, 406 F.2d 1363, 1367–68 (1969).

[3] The Submerged Lands Act, 67 Stat. 29 (1953), 43 U.S.C. § 1301–15, granted title to the coastal states of submerged lands within the 3-mile limit.

convey a property interest enforceable against the Government, of course, but it is an interest lacking many of the attributes of private property. Oil and gas deposits beneath the continental shelf are precious resources belonging to the entire nation. Congress, although encouraging the extraction of these resources by private companies, provided safeguards to insure that their exploitation should inure to the benefit of all. These safeguards are not limited to those provided by covenants in the lease; Congress also authorized the Secretary to maintain extensive, continuing regulation of the oil companies' day to day drilling operations.[4]

Section 5(a)(1) of the OCSL Act, 43 U.S.C. § 1334(a)(1), provided that:

> The Secretary shall administer the provisions of this subchapter relating to the leasing of the outer Continental Shelf, and shall prescribe such rules and regulations as may be necessary to carry out such provisions. The Secretary may at any time prescribe and amend such rules and regulations as he determines to be necessary and proper in order to provide for the prevention of waste and conservation of the natural resources of the outer Continental Shelf, and the protection of correlative rights therein, and, notwithstanding any other provisions herein, such rules and regulations shall apply to all operations conducted under a lease issued or maintained under the provisions of this subchapter. In the enforcement of conservation laws, rules, and regulations the Secretary is authorized to cooperate with the conservation agencies of the adjacent States. Without limiting the generality of the foregoing provisions of this section, the rules and regulations prescribed by the Secretary thereunder may provide for the assignment or relinquishment of leases, for the sale of royalty oil and gas accruing or reserved to the United States at not less than market value, and, in the interest of conservation, for unitization, pooling, drilling agreements, suspension of operations or production, reduction of rentals or royalties, compensatory royalty agreements, subsurface storage of

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[4] The Ninth Circuit also observed that:

"'* * * Careful study of the Act confirms that Congress intended to exercise both proprietary powers of a landowner and the police powers of a legislature in regulating leases of publicly owned resources. *Cf. Forbes* v. *United States*, 125 F.2d 404, 408 (9th Cir. 1942). The Secretary, to whom Congress has delegated these powers, may prescribe at any time those rules which he finds necessary for the conservation of natural resources. 43 U.S.C. § 1334(a)(1) * * *'" (512 F.2d at 747.)

> oil or gas in any of said submerged lands, and drilling or other easements necessary for operations or production.

Section 4(f) of the OCSL Act, 43 U.S.C. § 1333(f) provided that:

> The authority of the Secretary of the Army [acting through the Army Corps of Engineers] to prevent obstruction to navigation in the navigable waters of the United States is extended to artificial islands and fixed structures located on the Outer Continental Shelf.[5]

Both Interior[6] and the Army Corps of Engineers[7] (Corps) issued regulations implementing the OCSL Act.

The lease (Form 3380–1) binding the plaintiffs and the Bureau of Land Management (BLM), Department of the Interior, provided that the lease was entered into "* * * under, pursuant, and subject to the terms of the Outer Continental Shelf Lands Act of August 7, 1953 * * * and to all lawful and reasonable regulations of the Secretary of the Interior * * * when not inconsistent with any express and specific provisions herein, which are made a part hereof."

Under section 1 of plaintiffs' lease, they, as lessees, were given:

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[5] The authority of the Secretary of the Army referred to in section 4(f) issues from section 10 of the River and Harbors Act, 33 U.S.C. § 403 (1970). While the language in the OCSL Act does not, *in haec verba*, require the Secretary of the Army to consider matters unrelated to navigation, it has been held that the authorization of 33 U.S.C. § 403 permits the Secretary of the Army to consider ecological factors as well as navigational factors in carrying out his responsibilities in this area. *Zabel* v. *Tabb*, 430 F.2d 199, 214 (5th Cir. 1970), *cert. denied*, 401 U.S. 910 (1971).

[6] Interior issued regulations on May 8, 1954, which dealt with the granting of and operations under oil and gas leases on the OCSL (19 Fed. Reg. 2661). These regulations were revised and recodified in 1964 (43 C.F.R. § 3380). The regulations established, *inter alia*, a standard form oil and gas lease. Initially the lease was identified as Form 4–1255, but in February 1966, the lease was modified somewhat and redesignated as Form 3380–1. Other regulations required a lessee to file with an appropriate United States Geological Service (USGS) office a plan of development and an application for a permit to install a platform on a tract relative to lease implementation. (30 C.F.R. § 250.34).

[7] Army Corps of Engineers (Corps) regulations were issued on December 18, 1968 (33 Fed. Reg. 18,670). These regulations required, *inter alia*, a lessee to obtain a permit from the Corps before any installation could be placed on a tract on the OCSL.

> * * * [T]he exclusive right and privilege to drill for, mine, extract, remove and dispose of all oil and gas deposits * * * [in or under Tract 401]
>
> * * * * *
>
> (c) the right to construct or erect and to maintain within the leased area [Tract 401] all * * * platforms, fixed or floating structures * * * pipelines * * * and other works and structures necessary or convenient to the full enjoyment of the rights granted by this lease * * *.

Section 2(c) of plaintiffs' lease required them:

> * * * Within 30 days after demand, to subscribe to and to operate under such reasonable cooperative or unit plan for the development and operation of the area, field, or pool, or part thereof * * * as the Secretary [of the Interior] may determine to be practicable and necessary or advisable in the interest of conservation which plan shall adequately protect the rights of all parties in interest, including the United States.

- B -

The findings of fact deal in great detail with the varied and myriad facts advanced by the parties in this litigation. For present purposes only a brief account of the facts will be set forth in order to place the positions of the parties in proper perspective. Discussion of additional facts will occur when the arguments of the parties are considered.

The Santa Barbara Channel (the Channel) runs in an east-west direction between the coast of Southern California from Point Conception to Port Hueneme and the offshore islands of San Miguel, Santa Rosa, Santa Cruz, and Anacapa. The Channel is about 70 miles long (east-west) and varies from about 10 to 30 miles in width (north-south). The Channel area has a number of oil and gas fields; and natural hydrocarbon seeps, both onshore and offshore, are a widespread phenomenon in the area.

Offshore oil production in the Channel commenced without specific state or federal permission in 1896 by means of wells drilled from piers. Oil production from the Channel has continued since that time. After 1921,

pursuant to state policy, California authorized exploration for hydrocarbons in the Channel. This exploration resulted in the discovery of a number of fields which yielded substantial hydrocarbon production. However, in response to protests from residents and officials of the City of Santa Barbara that exploration for and production of oil and gas on state lands in the Channel area bordering the city would be unsightly, the State of California, in 1955, established a "sanctuary area" 16 miles long, from shoreline to the 3-mile limit, wherein no exploration or leasing would be permitted. This sanctuary embraced a coastal area which featured the City of Santa Barbara as its approximate midpoint. Interior was well aware of this sanctuary and attendant history when it set in motion the advertisement which led to the 1968 lease sale.

Sometime in 1965 the United States Geological Service (USGS) became alert to the significance of the fact that the Carpinteria oil and gas field in the Channel extended under both state lands and federal lands. California had leased a tract of state land in the Channel for oil and gas production from the Carpinteria field prior to November 1965. USGS believed that if state oil and gas production from the Carpinteria field continued, drainage from the Carpinteria field under federal land would occur thereby depriving the Federal Government and its potential lessees of revenues. Accordingly, Interior solicited bids for lease sale of Tract 298 (OCS–P–0166). This tract was directly east of plaintiffs' Tract 401. Both Tract 298 and Tract 401 were located on portions of the Carpinteria oil and gas field in the Channel. In December 1966, Tract 298 was awarded to a group consisting of. the Phillips Petroleum Company, Cities Service Oil Company, and Continental Oil Company (the Phillips Group). Subsequently, the Phillips Group installed two drilling platforms on Tract 298 (known as Platforms Houchin and Hogan) both of which were producing gas and oil from the Carpinteria field by November 1969.

In December 1966, BLM invited, by public notice, oil companies to indicate, without committing themselves, those tracts in the Channel which they might be interested in leasing. A press release described the procedures in this

regard. This proposed federal leasing program in the Channel generated protests from various state-county-city (California) and other groups. These groups maintained that a federal leasing program would impinge on the state's sanctuary area and would serve to encourage and/or require the state to lease sanctuary lands to prevent federal drainage of said state lands. Further, these groups argued that additional leases would mean additional drilling platforms which would mar the aesthetics of the ocean view from the shore. The protesting groups met with Interior officials on the matter. Thereafter, Interior decided that a 2-mile strip of federal land seaward of the state sanctuary land would not be leased, except for two tracts - Tract 401, plaintiffs' tract, and Tract 402. Tract 402 was subsequently leased to a group composed of Union Oil Company of California, Mobil Oil Corporation, Gulf Oil Corporation, and Texaco, Inc. (the Union Oil Group). Tract 402 was situated directly west of plaintiffs' Tract 401. Both Tract 402 and Tract 401 were located on a portion of the Dos Cuadras oil and gas field.

Before embarking on a federal lease program in the Channel, Interior gave consideration to the visual impact (aesthetics) of above-water installations on the Channel lease tracts. Interior also prepared other studies while considering this lease program. In December 1967, Interior offered some 110 parcels of Channel land for general lease sale. A lease sale was held on February 6, 1968, in Los Angeles, California. As a result of this sale, leases were awarded on 71 parcels of land in the Channel for a total payment to the Federal Government of $602,719,261.60.

Plaintiffs were successful bidders at the February lease sale for Tract 401, for which they paid the Federal Government $38,380,032. A formal lease was executed by Interior and the plaintiffs on April 1, 1968.

Platform Hillhouse

After plaintiffs acquired the lease to Tract 401, they commenced exploration activities. They confirmed that the oil-bearing sands of the Dos Cuadras field extended under the northwestern portion of Tract 401. As indicated earlier,

the Dos Cuadras field also extended under the northeastern portion of Tract 402 which the Union Oil Group leased as a result of the February 1968 sale.

By November 1968 plaintiffs decided to construct a platform, called Hillhouse, on the western portion of Tract 401, from which to drill for and produce oil and gas from the Dos Cuadras oil and gas field. Plaintiffs signed a contract on February 11, 1969, with J. Ray McDermott, Inc. (McDermott) to construct Platform Hillhouse. This contract resulted from negotiations with McDermott by plaintiffs which ostensibly began in November 1968. On May 1, 1969, plaintiffs signed a drilling contract with Island Drilling, Inc.

On January 24, 1969, plaintiffs submitted to the Pacific Regional Supervisor, USGS, a plan for development of the west side of Tract 401, including proposals for the construction and placement of Platform Hillhouse.[8] Because of the Union Oil blow out on January 28, 1969, which will be discussed next, plaintiffs, on February 6, 1969, withdrew the plan of development mentioned above.

The Union Oil Group, Union Oil was the operator for the Group, acquired Tract 402 at the February 6, 1968, sale. As indicated earlier, this Tract was directly east of and adjacent to plaintiffs' Tract 402. Both Union Oil and plaintiffs were to tap the same oil field. On April 18, 1968, Union Oil applied to the Pacific Regional Supervisor, USGS, for permission to erect Platform A on the northeastern portion of Tract 402. Union Oil supplied the Regional Supervisor—the record does not indicate why—with supplemental information on April 29, 1969. The Pacific Regional Supervisor, USGS, granted final approval to Union Oil's application on May 6, 1968. In September 1968 Union Oil erected Platform A on Tract 402. This platform was located 1,350 feet west of the boundary line between

[8] The pertinent regulations (30 C.F.R. § 250.34 (1964)) required that a plan of development be submitted for approval after an oil and gas discovery has been made on a leased tract. The regulations also provided that any plan approved by the Regional Supervisor "may be modified from time to time as conditions may warrant." Procedures governing the submission of a plan of development were set out in 30 C.F.R. § 250.34(b) (1964).

Union Oil's Tract 402 and plaintiffs' Tract 401. It was installed to produce oil and gas from the Dos Cuadras field.

By January 26, 1969, Union Oil had completed three wells from Platform A and two additional wells were being drilled. On the morning of January 28, 1969, the fifth well being drilled from Platform A blew out. The blow out caused a massive oil spill in the Channel, killing birds and marine organisms, damaging beaches and seafront properties and restricting fishing and recreational activities in the Santa Barbara coastal area. *See Union Oil Company of California* v. *Morton, supra,* 512 F.2d at 746. The seepage of oil, polluting the Channel and adjacent coastline, continued into February 1969. The area from which oil seepage occurred extended from a point approximately 1,300 feet west of Union Oil's Platform A to a point on plaintiffs' Tract 401 approximately 2,600 feet east of Platform A. This blow out set in motion the chain of events which underscore this litigation.

Following the Union Oil blow out, a series of investigations, reviews of existing procedures, and reconsiderations of the federal leasing program in the Channel took place. The atmosphere surrounding these efforts was clouded by clamor from many public and private groups and individuals who were opposed to the federal Channel leasing program. Indeed, bills were introduced in the Congress of the United States to terminate all drilling in the Channel. A federal sanctuary plan under which some 20 Channel leases, later expanded to cover 35 Channel leases, would be revoked and the tracts associated therewith placed in said sanctuary was the subject of bills introduced in the Congress. This plan, however, did not include plaintiffs' Tract 401, Union Oil's Tract 402, or the Phillips Group's Tract 298. None of the legislative efforts spawned by the Union Oil blow out were successful.

As a result of the Union Oil blow out, Interior suspended drilling and production operations on federal leased tracts in the Channel.[9] Initially, Interior took steps directly related to the containment of the oil spill in the Channel

[9] This suspension did not apply when it was necessary to drill on the Union Oil blow out well in order to relieve damaging pressure.

area. Thereafter, Interior was concerned about assuring that future operations would not result in a recurrence of a Union Oil type blow out.

On March 3, 1969, Interior allowed drilling and production from the Carpinteria field on the Phillips Group's Tract 298 to resume on a temporary basis. This authorization was made permanent on April 1, 1969.

Of the investigations conducted as a result of the Union Oil blow out, the most prestigious was that conducted by the DuBridge Committee.[10] The DuBridge Committee announced its report and recommendations on June 2, 1969, and suggested an order of priorities be established relative to Channel activity on federal-leased lands. The first priority recommended by the Committee was to control the oil seepage. The sixth, and final, priority recommended by the Committee was to deplete all Dos Cuadras Repetto reservoirs as efficiently and rapidly as possible consistent with safety.

On June 9, 1969, Interior authorized Union Oil to drill nine wells from Platforms A and B. These nine wells were drilled, completed, and, with the exception of one well on which drilling was suspended by Union Oil itself, put into production during the months of June and July 1969, without incident.

On April 18, 1969, plaintiffs submitted a revised plan of development of the west side of Tract 401. This revised plan was received by the Pacific Regional Office, USGS, on April 25, 1969. The revised plan was not inconsistent with any applicable rule, regulation or order of Interior. Plaintiffs' revised plan located Platform Hillhouse some 1,400 feet east of the boundary line of Union Oil's Tract 402 and approximately 2,750 feet east of Union Oil's Platform A.

On April 24, 1969, plaintiffs submitted an application to USGS requesting approval to install and maintain Plat-

[10] President Nixon appointed his science advisor, Dr. Lee DuBridge, to form an investigating committee to determine the proper course of action to be followed relative to continued Channel drilling and production from the Dos Cuadras oil and gas field. On April 7, 1969, President Nixon requested Dr. DuBridge to assemble another committee to make recommendations about future steps that should be taken regarding drilling and production on Union Oil Tract 402.

form Hillhouse on its Tract 401. This application was in accordance with the procedure required by 30 C.F.R. § 250.34(a) (1964).

On April 30, 1969, plaintiffs applied to the Corps for a permit to install Platform Hillhouse in the Channel on Tract 401.[11] This application was in full compliance with all applicable rules, regulations and orders of the Corps. Because their respective responsibilities overlapped to some degree, Interior and the Corps agreed that they would coordinate their OCSL actions, ostensibly to avoid duplication and inconsistent orders. It was agreed that the Corps would consider navigation and national security when acting on installation permits and Interior would cover all "general public interest matters" when authorizing development activity in the Channel. As implemented, the Corps processed installation permit applications after Interior had cleared tracts for lease development.

Plaintiffs' plan of development and their application to install Platform Hillhouse were under consideration by Interior from April 25, 1969, until August 15, 1969, when both were approved by the Secretary of Interior, Walter J. Hickel.

On August 25, 1969, the Corps began to process plaintiffs' Platform Hillhouse installation permit. This process[12] involved public hearings and generated public comment and input. It resulted in unsuccessful legal actions seeking restraining orders and injunctions barring granting of the installation permits.[13] The Corps issued the permits to plaintiffs on November 7, 1969.

Construction of Platform Hillhouse started on January 14, 1969, at the Kaiser Steel Company yards in Oakland, California. The platform was originally scheduled for completion on June 15, 1969. However, this schedule was

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[11] On May 7, 1969, plaintiffs made application to the Corps for a permit to install a submarine power cable from shore to Platform Hillhouse.

[12] On September 9, 1969, plaintiffs applied to the Corps for a permit to install an oil, gas and water pipeline bundle between Platform Hillhouse and Union Oil's Platform A. Both permits were processed by the Corps.

[13] The final decision by the District Court was rendered on November 3, 1969. The Ninth Circuit Court of Appeals upheld the action of the District Court on November 17, 1969, and the Supreme Court of the United States declined to hear the matter on November 25, 1969, *County of Santa Barbara* v. *Malley*, 396 U.S. 950 (9th Cir. 1969).

revised on February 27, 1969, at which time it was estimated that the earliest date for completion of the platform was July 30, 1969.

On April 21, 1969, plaintiffs met with McDermott, the platform contractor, and Kaiser Steel. A revised platform delivery date of August 11, 1969, was established. At this meeting, the impact of the January 28, 1969, Union Oil blow out was discussed. The minutes of this meeting provided in pertinent part:

1. Since Union's leak is still very much in evidence, Sun's application to develop Tract 401 has met with unforeseen delays.
2. Sun is extremely confident that the USGS will approve our development plan, and the Corps of Engineers will permit the platform.
3. Secretary Hickel could veto a USGS recommended approval of our plan and cancel the lease, but this seems very unlikely.
4. A formal presentation to the USGS of our development plan is to be made April 25, 1969. An application to install Platform Hillhouse will be submitted at this time. We do not expect an answer from the USGS until about May 16.
5. Sun is trying to coordinate the installation of the platform with construction of onshore producing facilities. It will be necessary to have these facilities operational before drilling will be permitted.

At this meeting, the participants also discussed the possibility of future platform delivery delay. Kaiser personnel recommended that, in any event, platform construction be completed without any delay or shut down, since "[s]hut down and resumption of work could be most costly." According to Kaiser, the platform components could be stored until delivery was possible, and that by good planning storage costs could be held to a minimum.

Between April 21, 1969, and June 17, 1969, construction work on Platform Hillhouse continued. On June 17, 1969, plaintiffs advised McDermott that they would be unable to accept delivery of the platform in accordance with the revised schedule established on April 21, 1969. Thereafter, work on the platform components slowed down and, on July 18, 1969, all construction work on the platform ceased

completely.[14] After Interior's approval of their permits on August 15, 1969, plaintiffs authorized McDermott to instruct Kaiser to resume construction work on the platform without delay. Construction work on the platform began again on September 2, 1969. On October 30, 1969, plaintiffs were advised that platform construction would be completed on November 10, 1969.

On this record it is reasonable to assume that if construction work on the platform had not been suspended, the platform would have been available at the earliest on August 11, 1969. This was only 4 days before Secretary Hickel granted plaintiffs' applications. However, on reading the minutes of the April 21, 1969, meeting, discussed above, it would not be unreasonable to assume a delivery date after August 15, 1969.

Installation of Platform Hillhouse on Tract 401 began on November 21, 1969, and required some 65 days. Plaintiffs took possession of the platform on January 21, 1970.

In order to prepare for oil and gas production, plaintiffs engaged in efforts to secure onshore facilities, a platform power supply, and a pipeline access from onshore to the offshore platform. These efforts, to one degree or another, served to delay plaintiffs' drilling preparations.

Plaintiffs were ready to drill their first well from Platform Hillhouse on April 6, 1970. On May 18, 1970, plaintiffs received authorization from the Pacific Regional Supervisor to drill without the availability of pipeline facilities to shore. On May 20, 1970, the District Engineer advised plaintiffs that Platform Hillhouse, its rigs and its equipment had been successfully inspected and that plaintiffs had approval to commence drilling operations. On May 25, 1970, plaintiffs commenced drilling on the first well from Platform Hillhouse. On June 16, 1970, plaintiffs' first well was completed and ready to produce.

On May 25, 1970, however, plaintiffs did not have available to them pipeline facilities for transmitting the oil

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[14] While not clear in the record, it seems reasonable to infer that plaintiffs directed McDermott and/or Kaiser to suspend construction work on the platform. As indicated above, Kaiser recommended against any interruption or delay in the construction of the platform regardless of any future extension of the estimated delivery date then contemplated by the April 21 conferees.

and gas from platform to shore. On July 21, 1970, plaintiffs were able to resolve the shore to platform pipeline facility problem. On and after July 21, 1970, plaintiffs obtained oil and gas production from Platform Hillhouse. This completed development of the west side of Tract 401 on which the Dos Cuadras oil and gas field was located.

Platform Henry

As indicated earlier, the east side of Tract 401 embraced the Carpinteria oil and gas field. The Phillips Group had been draining this field under a federal lease since June 10, 1968. Unitization of plaintiffs' Tract 401 with the Phillips Group's Tract 298 was not technically feasible in order to develop fully the Carpinteria field because the Phillips Group's Platform Houchin could not obtain maximum ultimate recovery from this field. Unitization was a cooperative procedure whereby two or more lessees would unite in drilling and production endeavors. Accordingly, it was necessary for plaintiffs to install their own platform in order to develop the east side of Tract 401.

On December 29, 1969, plaintiffs submitted their plan of development for the east side of Tract 401. On January 22, 1970, plaintiffs applied for a permit to install Platform Henry on the east side of Tract 401. Both submissions were sent to the Los Angeles Regional Office, USGS, and the permit transmittal letter requested rapid approval because delays would result in drainage of the oil and gas in the field by the Phillips Group's operations on Tract 298. As submitted, plaintiffs' east side plan of development and application for a permit to install Platform Henry were not inconsistent with any rule, regulation, or order of Interior.

By February 3, 1970, the Santa Barbara District Engineer and the Pacific Regional Supervisor, USGS, had recommended approval of plaintiffs' plan application and Platform Henry's permit. These recommendations were forwarded to the Washington office of USGS on or about February 3, 1970.

Public hearings on Platform Henry were held on January 14, 1971, in Santa Barbara, California. Shortly thereafter, Interior began to prepare a draft of an

Environmental Statement on the proposed installations of Platform Henry[15] in accordance with the procedures of the National Environmental Policy Act of 1969, 83 Stat. 852, 42 U.S.C. § 4331 (1970). The availability of the initial draft of the Environmental Statement was announced on May 11, 1971, and public comment was invited and received.

On August 23, 1971, a copy of the Final Environmental Statement was submitted to the Secretary, together with a recommendation from the Assistant Secretary of the Interior for Mineral Resources, that plaintiffs' application and permit be granted. No official of the Interior recommended to the Secretary that plaintiffs' application and permit for Platform Henry be denied on environmental or any other ground.

On September 20, 1971, Secretary of Interior, Rogers C. B. Morton, denied plaintiffs' permit to install Platform Henry "because of overriding environmental conditions."[16] On November 3, 1972, more than a year after denial of plaintiffs' permit application, and after commencement of this litigation, Secretary Morton issued a "Statement of Decision", wherein he listed some six grounds in support of his denial of the Platform Henry permit request. Secretary Morton had not spelled out these grounds in his decision of September 20, 1971, denying the permit application.

On September 29, 1975, plaintiffs submitted to the Los Angeles Regional Office, USGS, a plan of development for the east side of Tract 401, a request for a permit to install Platform Henry, and a request for approval to drill exploratory wells. On April 28, 1976, USGS, advised plaintiffs it could not approve the plan of development as submitted. It further advised plaintiffs that it could not approve drilling and platform installation requests together, but could approve, if separately submitted, drilling plans.

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[15] The Statement also involved consideration of Union Oil's application and permit to install Platform C on its lease Tract 402 in order to drill into the Dos Cuadras oil and gas field.

[16] Union Oil's application and permit for Platform C were likewise denied at the same time. Union Oil challenged this denial in *Union Oil Company of California* v. *Morton*, 512 F.2d 743 (9th Cir. 1975).

On July 9, 1976, plaintiffs submitted to USGS a plan to drill an exploratory well (well No. 9) on the east side of Tract 401. In early August 1976, plaintiffs submitted an Oil Spill Contingency Plan to USGS. On August 23, 1976, plaintiffs applied for a permit to drill well No. 9 into the Carpinteria field. USGS issued such a permit to plaintiffs on September 9, 1976. On plaintiffs' application, USGS issued a permit allowing plaintiffs to drill well No. 10 on the east side of Tract 401 on December 29, 1976. The drilling of well No. 10 was completed in January 1977.

The actions of the parties in 1975—1977, as related above, clearly indicate that they viewed the lease agreement between them as existing, valid, operative and enforceable. As of the date of final closing of proof in this case (February 3, 1977), no plan of development or application for a permit to install Platform Henry on the east side of Tract 401 had been approved by USGS.

II

Plaintiffs' breach of lease contentions relative to Platforms Hillhouse and Henry are premised on the general proposition that:

> * * * neither party to the contract will do anything to prevent performance thereof by the other party or that will hinder or delay him in its performance * * *.

Wah Chang Corp. v. *United States*, 151 Ct. Cl. 41, 49, 282 F.2d 728, 733 (1960); *see also* 5 WILLISTON, CONTRACTS § 670 at 159 (3d ed. 1961).

Specifically, as to Platform Hillhouse, plaintiffs claim that defendant unreasonably delayed them in their efforts to install said platform on the west side of Tract 401 and to produce oil and gas therefrom. *See George A. Fuller Co.* v. *United States*, 108 Ct. Cl. 70, 94–102, 69 F. Supp. 409 (1947); *see also Lewis-Nicholson, Inc.* v. *United States*, 213 Ct. Cl. 192, 200–01, 203–05, 550 F.2d 26, 30, 32 (1977). With respect to Platform Henry, plaintiffs challenge defendant's denial to them of permission to install said platform on the east side of Tract 401 as unjustified. *See Neely* v. *United States*, 152 Ct. Cl. 137, 145, 285 F.2d 438, 442 (1961).

The disputes between the parties center on whether the established facts fit the mold of case law which requires that defendant respond by way of breach of contract damages if it unreasonably delays a lessee in contract performance or if it unjustifiably prevents a lessee from performing under its contract.

It is important, when considering the contentions of the parties, to bear in mind that the lease contract between the parties was entered into:

> Under, pursuant and subject to the terms and provisions of the * * * [OCSL Act], and to all lawful and reasonable regulations of the Secretary of the Interior * * * when not inconsistent with any express and specific provisions herein, which are made a part hereof * * *.

The circumstances relative to issuance of the lease in question, the milieu in which lease performance was to take place, and the environmental concerns implicit in the totality of the federal leasing program on OCSL cannot be overlooked in the consideration of the present claims. The actions of the Secretary, herein challenged, must be viewed in the light of the obligations, duties and responsibilities placed on him by the OCSL Act, the very Act which gave birth to the lease now in issue. Plaintiffs' lease rights are not absolute and unqualified under the circumstances. However, the Secretary's power and authority to obliterate and/or interfere with vested lease rights is not absolute. The Secretary would have to respond in damages for unbridled, unjustified and unreasonable interference with plaintiffs' lease rights.[17] *See Union Oil Company of California* v. *Morton, supra.*

The crucial factual determinations to be reached herein are whether the actions of the Secretary and the actions of the Corps, were unreasonable and unjustified under the circumstances in which they were taken. Since a determination of whether defendant's actions regarding Platform Hillhouse constituted a breach of lease brings into consideration factors that are not involved in the determination of whether defendant's actions with respect to Platform

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[17] This is also true with respect to actions on the part of the Corps relative to its role in OCSL activities pertaining to Platform Hillhouse.

Henry constituted a breach of lease, the following discussion will deal separately with the claims associated with these platforms.

Platform Hillhouse

Plaintiffs put forth three separate delay claims covering the period April 25, 1969—July 21, 1970, aggregating some 189 days of delay. April 25, 1969, was the date when plaintiffs' revised plan of development and permit for installation of Platform Hillhouse was received by USGS for approval. July 21, 1970, was the date when plaintiffs began producing oil and gas from Platform Hillhouse.

First, plaintiffs maintain that the period from August 11, 1969, when the platform was scheduled to be completed, to November 10, 1969, when the platform was actually completed (91 days), constitutes a period of unreasonable delay occasioned solely by the failure of Interior to promptly process, approve and issue the application and permit necessary for the construction and installation of Platform Hillhouse. Plaintiffs further maintain that the unreasonable delay of the Corps in processing their navigation permit required plaintiffs to install the platform in the winter season. Plaintiffs allege that during this winter season they were delayed 21 days by adverse weather conditions which would not have been encountered if the Corps had approved this permit more promptly. Accordingly, plaintiffs seek delay damages for 112 days resulting from events which occurred, or failed to occur, during the period April 25, 1969—January 21, 1970. January 21, 1970, was the date when Platform Hillhouse was installed on Tract 401.

Second, plaintiffs seek to recover delay damages for the period from April 6, 1970, when plaintiffs were ready to drill their first well from Platform Hillhouse, to May 18, 1970, when USGS granted approval to plaintiffs to commence drilling. Plaintiffs claim 42 days of delay.

Third, and finally, plaintiffs seek to recover delay damages for the period from June 16, 1970, when plaintiffs' first well on Platform Hillhouse was completed and ready to produce, to July 21, 1970, when plaintiffs began

producing oil and gas from said platform. Plaintiffs claim 35 days of delay.

a. *The first delay claim period*

Upon receipt of plaintiffs' plan of development and request for an installation permit on April 25, 1969, Interior began the process of review attendant thereto.[18]

On May 5, 1969, the Santa Barbara District Engineer, USGS recommended to the Pacific Regional Supervisor, USGS, that plaintiffs' plan of development and application to install Platform Hillhouse be approved. The Pacific Regional Supervisor, in turn, recommended approval of plaintiffs' plan and permit application on May 16, 1969, together with a request that a geologic clearance be processed without too much delay.[19] On June 3, 1969, the Acting Oil and Gas Supervisor, Pacific Region, USGS, and the Regional Geologist, USGS, recommended approval of plaintiffs' plan and permit application. The matter was then forwarded to the Washington office of USGS where, on June 30, 1969, the Director, USGS, recommended to the Secretary of the Interior, Walter J. Hickel, that both plaintiffs' plan of development and installation permit be approved.

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[18] The authority of Interior to approve plans of development and to regulate issuance of installation permits relative to OCSL leases is not challenged. The crux of plaintiffs' claim is that Interior took an unreasonably long period of time in effectuating the review process.

[19] At the time the lease was entered into, the Regional Supervisor had been authorized to act as representative of the Secretary of the Interior relative to lease activities on the OCSL (30 C.F.R. § 250.2(c)(1966)). Prior to the Union Oil blow out, the Regional Supervisor was authorized, *inter alia*, to approve a plan of development and to issue an installation permit (30 C.F.R. §§ 250.11 and 250.34 (1966)). After the blow out, Secretary Hickel withdrew the Regional Supervisor's approval authority and required his personal approval of any plan of development and installation permit under OCSL leases. Under the circumstances, this action by Secretary Hickel is considered authorized, proper and reasonable. The Secretary's action in this regard was not published in the Federal Register. Plaintiffs' briefs do not advance any legal argument relative to this lack of publication. In any event, while not crystal clear, the record does suggest that plaintiffs were aware, at all material times, that the Secretary and not the Regional Supervisor, would have to approve their plan of development and installation permit (*see* text *ante*, at 736). *See Timber Access Industries Co.* v. *United States*, 213 Ct. Cl. 648, 656–57, 553 F.2d 1250, 1254–55 (1977). *Miller* v. *United States*, 209 Ct. Cl. 135, 144, 531 F.2d 510, 515 (1976).

As indicated earlier, the DuBridge Committee issued its report on June 2, 1969. One of its recommendations was that the Dos Cuadras Repetto reservoirs be drained as efficiently and rapidly as possible consistent with safety. Such draining would serve to relieve pressure in these reservoirs. On June 9, 1969, Interior authorized Union Oil to drill nine wells from Platforms A and B in order to drain said reservoirs. Eight of these wells were drilled and put into production during the months of June and July 1969 without incident. This activity by Union Oil undoubtedly supplied Interior with needed information although the record is most skimpy in this area. In any event, Interior requested plaintiffs to conduct a surface survey on their tract for bubbles.[20] Plaintiffs did so on August 4, 1969, and reported the absence of any bubbles. During the second week of August 1969, plaintiffs were requested by Interior to further revise their plan of development. After meeting with Secretary Hickel on August 11, 1969, plaintiffs revised their plan of development. They submitted their revised plan of development to Interior on August 15, 1969, and approval was given that same day.

Plaintiffs argue that this approval by Interior on August 15, 1969, of submissions received by Interior on April 25, 1969, was unreasonably long in duration. Plaintiffs suggest that approval should have been finalized when the Regional Supervisor recommended approval on May 16, 1969,[21] pointing out that the Regional Supervisor had such final approval authority at the time the lease was entered into. However, this was before the Union Oil blow out.[22]

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[20] It is important to note that the area from which oil seeped as a result of the January 28, 1969, blow out was just some 150 feet from where Platform Hillhouse was to be installed. Presumably, the presence of surface bubbles would indicate that drilling on the Repetto reservoirs was not safe.

[21] Plaintiffs argue further that their plan and installation permit approval should have been granted at the very latest on June 17, 1969. Plaintiffs select this date because it is the date on which the plaintiffs instructed their contractor to suspend construction work on the platform. If the sought-for approval had been received on or before June 17, 1969, plaintiffs undoubtedly would not have suspended platform construction work.

[22] In support of the May 16, 1969, date, plaintiffs note that Union Oil received approval to install Platform A within 3 weeks of its application for plan and installation permit approval. The blow out and its aftermath, however, serve to deprive this comparison of any merit.

Such an argument has little surface appeal under the circumstances existing after the blow out. The blow out was a devastating event and required careful, prudent and cautious actions by Interior to control the oil spill first, and, second, to assure that such a blow out did not occur again. It is in this climate that the actions of Interior in processing plaintiffs' application for plan and installation permit approval must be examined.

It has been held that "[w]hat is a reasonable period of time for the government to do a particular act under the contract is entirely dependent upon the circumstances of the particular case." *Tri-Cor, Inc.* v. *United States*, 198 Ct. Cl. 187, 221, 458 F.2d 112, 131 (1972). Plaintiffs can prevail on their delay claims only if they can establish that any such delay was unreasonable under the existing circumstances. Moreover, plaintiffs must also show that defendant's approval delay was the primary cause of the delay in the installation of Platform Hillhouse. *See L. L. Hall Constr. Co.* v. *United States*, 177 Ct. Cl. 870, 878, 379 F.2d 559, 563 (1966). This is so because it would be of no avail to plaintiffs if the plan and permit application had been approved but construction of the platform not completed. In this situation, installation could not take place and plan and permit application approval lose significance.

When plaintiffs' plan of development and installation permit requests were received by USGS on April 25, 1969, the effects of the Union Oil blow out in the Santa Barbara Channel were still being felt. This blow out, as indicated before, involved severe and extensive environmental damage to the Channel and coastal area. Under the OCSL Act, 43 U.S.C. § 1334(a)(1)(1970), the Secretary was responsible for the administration of OCSL leases and was under a duty to protect the environment against waste and to conserve natural resources. *See Gulf Oil Corp.* v. *Morton*, 493 F.2d 141 (9th Cir. 1973).[23] Accordingly, it was not only reasonable, but also the legal obligation of the Secretary to employ procedures different from those followed prior to

[23] The environmental responsibilities and duties imposed by Congress cannot be lightly assumed by the Secretary. *See Sierra Club* v. *Department of the Interior*, 398 F. Supp. 284 (N.D. Cal. 1975), *modified*, 424 F. Supp. 172 (1976). (Redwood National Park Act, 16 U.S.C. § 79a-j.)

the blow out to assure that such disasters would not occur.[24]

Following the blow out, plaintiffs' plan of development and installation permit were subjected to review and study at various levels of USGS. This USGS review and study consumed some 68 days (April 25, 1969—June 30, 1969). Under the circumstances of the blow out and the technical, scientific and environmental matters involved, 68 days is not considered unreasonable, *per se*. This multilevel USGS review process provided a reasonable means to ensure greater protection against the risk of future environmental harm.[25] Its purpose was to make sure that installation of Platform Hillhouse would not have an adverse impact on the Channel environment. On this record, there is no evidence that USGS personnel were dilatory in performing their review and study duties relative to processing plaintiffs' plan and permit submissions. Moreover, there is a presumption that public officials perform their duties in a proper manner. *United States* v. *Chemical Foundation, Inc.*, 272 U.S. 1, 14–15 (1926); *Librach* v. *United States*, 147 Ct. Cl. 605, 612 (1959). That presumption stands unrebutted on this record. Under the circumstances, the period from April 25, 1969, to June 30, 1969, cannot be considered to be an unreasonable period for purposes of USGS review, study and recommendations relative to plaintiffs' plan and permit applications.[26]

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[24] While Union Oil's plan of development and permit applications were approved 3 weeks after they were submitted, which was before the blow out, some 4 months were spent in review and study of Union Oil's operations (February 7, 1969—June 9, 1969) before Union Oil was permitted to resume production after the blow out. The point, which plaintiffs seem to lose sight of, is that the blow out gave rise to a "whole new ball game."

[25] It should be noted that each level of review and study produced a recommendation which, in turn, was forwarded to the next level of review for consideration. Such a procedure requires reasonable time. *See Scott* v. *United States*, 44 Ct. Cl. 524, 531 (1909).

[26] The cases cited by plaintiffs espouse the general rule that unreasonable delay engendered by defendant gives rise to delay damages. However, the factual predicates in each of those cited cases make them inapposite. For example, in *United States Casualty Co.* v. *United States*, 107 Ct. Cl. 46, 67, 67 F. Supp. 950, 954 (1946), it was held that a 4-day delay in defendant's review and approval of certain plans was unreasonable "[s]ince this was a routine matter." In the instant case, review of plaintiffs' plans in the climate of blow out fever was far from a routine matter. It embraced technical, scientific and environmental complexities of a high order. Further, in *Law* v. *United States*, 195 Ct. Cl. 370, 397 (1971), the court found

USGS forwarded plaintiffs' plan and permit applications, with favorable recommendations, on June 30, 1969, to Secretary Hickel. As indicated earlier, Union Oil had been permitted to drill some eight wells in the area during the period June—July 1969.[27] These wells were completed without incident thereby generating a feeling that future drilling and oil production from the Dos Cuadras field could be accomplished in safety. It was reasonable for the Secretary to await the completion of Union Oil drilling in the Dos Cuadras field since this was the very same field on which Platform Hillhouse was to be installed. After Union Oil's success in drilling into the Dos Cuadras field, a bubble test, performed by plaintiffs at defendant's request, indicated that no oil or gas was seeping through fractures or fissures in the Dos Cuadras field. This was a confirmation that additional drilling by plaintiffs could be done safely. Thereafter, Secretary Hickel, after plaintiffs revised their plan as requested, approved said plan on August 15, 1969. The factual recitation above does not establish any unreasonable delay or actions on defendant's part. Instead, the actions reflect a prudent and cautious effort to protect the Channel environment from any risk of harm. On this record, the unrebutted presumption is that the Secretary performed his duties in a proper and responsible manner.

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defendant's delay in approving shop drawings unreasonable in that the defendant had undoubtedly spent a good deal of time on the design of the foundations, even prior to the bid invitations, to which the shop drawings were addressed and thus defendant was familiar with the substance of these shop drawings. Moreover, the court did not look kindly on defendant utilizing approval of the shop drawings as a means to effect important design changes thereby engendering delay. The circumstances of this case, on the other hand, reveal that defendant was not previously aware of the various attributes of Platform Hillhouse until said plans were submitted, and received them in the context of unfamiliar and extraordinary circumstances. Moreover, whether or not installation of such a platform in the Channel was environmentally and technically feasible was a matter that required considerable review and study, especially in view of the recent blow out in the installation area.

[27] It should be noted that Union Oil was prevented from production drilling from February 7, 1969—June 9, 1969. During this 4-month period, various investigations, studies and reviews were conducted as to whether further drilling in the Dos Cuadras field was possible. It was not until the DuBridge Committee report was issued on June 2, 1969, that continued drilling in this field was cautiously recommended. This 4-month period does serve to indicate that consideration of this complex and highly important environmental situation required time and detailed study.

See United States v. *Chemical Foundation, Inc., supra; Librach* v. *United States, supra.*

On this record, and under the circumstances recited above, it must be concluded that defendant was not responsible for any unreasonable delay in the processing, review and approval of plaintiffs' plan of development and installation permit request. The unique situation generated by the extraordinary Union Oil blow out and resulting oil spill dictated that defendant proceed with deliberate prudence and caution in approving the installation of another drilling platform in the very area which produced the disaster. It was reasonable for defendant to so proceed.

At the time plaintiffs' plan and permit request were approved on August 15, 1969, Platform Hillhouse had not been constructed. Accordingly, plaintiffs were not in a position to begin development of Tract 401 until their platform had been constructed and installed. Without more, this absence of a constructed platform renders any delay in plan and permit approval of little or no significance since such a delay would not delay the ultimate completion of the project. *See Law* v. *United States*, 195 Ct. Cl. 370, 385 (1971). However, plaintiffs respond that they directed their platform contractor to suspend work on the platform on June 17, 1969, precisely because they had not received plan or permit approval and had no idea when such approval would be forthcoming. The question to be answered here is whether plaintiffs were reasonable in directing their platform contractor to suspend work on the platform.[28]

Plaintiffs maintain that it would have been unreasonable for them to continue platform construction in the light of the uncertainty as to when, if ever, their plan and permit submissions would be approved. However, the facts of record indicate that plaintiffs were unreasonable in this regard.

Indeed, plaintiffs were not motivated by approval considerations when they authorized construction work on the

[28] Plaintiffs, in April 1969, anticipated completing the platform for installation purposes around August 11, 1969. In retrospect, had plaintiffs not suspended work on the platform and it was ready on or about mid-August 1969, there obviously would be no valid plan and permit approval delay contention advanced herein.

platform to begin on January 14, 1969, before they even submitted their first plan of development and installation permit request.[29] It is obvious that platform construction was not dependent on plan and/or permit approval. No provision of the lease agreement or relevant regulations covering lease operations required prior approval of Interior before constructing a platform, nor can the suspension of construction work on the platform be viewed as an effort to minimize damages should defendant fail to give approval. Under the lease plaintiffs had a vested right to install a platform. *See Union Oil Company of California* v. *United States, supra,* 512 F.2d at 750. Had defendant refused to grant this approval, plaintiffs would have been entitled to breach of contract damages, which would include incurred reasonable platform construction costs. See the discussion, *infra,* as to Platform Henry.

Two other important facts bear on the reasonableness of plaintiffs' suspension of platform construction work. First, defendant did not order or direct plaintiffs to suspend and halt platform construction work. It was a unilateral act on plaintiffs' part, taken without consultation with and without a word to defendant. It was a business judgment exercised by plaintiffs. Second, and most important, the suspension and final work halt was taken against the recommendation of the platform contractor. The possibility of installation delay was given consideration by plaintiffs and their contractor in April 1969. The platform contractor advised plaintiffs that it would be less costly to furnish the platform and then store it while awaiting permission to install it, rather than suspend production thereof. Why the plaintiffs elected to ignore this advice is not revealed in the record. The record suggests, and of course is reinforced by but not influenced by hindsight, that plaintiffs did not act reasonably under the circumstances in suspending platform construction work on June 17, 1969. Had plaintiffs allowed platform construction work to continue, installa-

[29] Plaintiffs submitted their first plan of development and installation permit request on January 24, 1969. Following the blow out on January 28, 1969, plaintiffs withdrew their first submissions on February 6, 1969. On April 18, 1969, plaintiffs submitted a revised plan and a permit request. Interestingly, plaintiffs never suspended construction work on the platform during this period.

tion thereof would have blended rather nicely with the plan and permit approval given by defendant on August 15, 1969.

Plaintiffs also proffer several other contentions which they allege manifest unreasonable actions by defendant. However, these contentions are subsumed by the determinations reached above that defendant did not unreasonably delay approval of plaintiffs' plan and permit applications, and, in any event, plaintiffs' actions in suspending construction work on the platform was the primary cause of the platform being completed on November 10, 1969, instead of mid-August 1969.

For example, plaintiffs complain that defendant was unreasonable in not immediately implementing the DuBridge Committee Report recommendation that the Dos Cuadras Repetto reservoirs be depleted as efficiently and rapidly as possible consistent with safety. That report was issued on June 2, 1969. Defendant authorized Union Oil, on June 9, 1969, to drill wells from Platform A, which was already installed on its tract, in implementation of the DuBridge Committee recommendation. There was no unreasonable delay or action present. Since plaintiffs' platform had not been constructed, or installed, plaintiffs were in no position to drill wells.

Plaintiffs also argue that the Corps unreasonably delayed issuance to them of a permit to install Platform Hillhouse in the Channel. Plaintiffs' reason that if the Corps had issued the permit more promptly, no later than August 15, 1969, they would not have had to install the platform during the winter season. Since the platform was installed during the winter season, some 21 working days were lost because of adverse weather conditions. Plaintiffs attribute these 21 days of delay to the Corps.

Plaintiffs applied to the Corps for an installation permit on April 30, 1969. It is conceded that the Corps had the authority to require and issue such a permit before the platform could be installed in the Channel. Because of overlapping responsibilities, the Corps and Interior reached agreement that the Corps would be primarily responsible for navigation and national security aspects of permit

authorization and Interior would be primarily responsible for environmental and other matters.[30] As a result, it was agreed that the Corps would not process any installation permits until Interior had cleared a platform for installation. Under the circumstances, the action of the Corps in not immediately processing plaintiffs' permit request was not unreasonable. Again, the blow out and its aftermath must be borne in mind. Accordingly, the Corps did not process plaintiffs' permit request, as well as other lessee permit requests, until advised by Interior of its clearance of Tract 401 for platform installation.

After Interior approved plaintiffs' plan and installation permit application on August 15, 1969, the Corps began to process plaintiffs' permit from a navigational and national security point of view. The public notice associated with this process generated public hearings and law suits. As a result, the Corps was finally able to issue the permit to plaintiffs on November 7, 1969. While this date was approximately 6 months after plaintiffs had submitted their permit request, and nearly 3 months after Interior had cleared plaintiffs' plan and authorized installation of Platform Hillhouse, it came 3 days before construction work on Platform Hillhouse was scheduled to be completed.[31] Since the Corps issued the installation permit to plaintiffs before Platform Hillhouse was completed and ready for installation, the permit processing actions of the Corps resulted in no delay in the installation of Platform Hillhouse. *See Law* v. *United States, supra,* 195 Ct. Cl. at 385.

Plaintiffs' claim for delay damages covering actions and/or inactions of Interior and the Corps during the period April 25, 1969—January 21, 1970, aggregating 112 days, is not supported by the record in this case.

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[30] Such agreements are not unusual in these circumstances and they have been viewed favorably by the courts and the Congress. *See Zabel* v. *Tabb, supra* note 5, at 210–11. These agreements avoid duplication of effort and avoid uncertainty as to clearance responsibility and duty. While such cooperative endeavors were not required by the OCSL Act, *supra,* they were not proscribed by that Act.

[31] The component parts of Platform Hillhouse were barged to Tract 401 and installation of the platform began on November 21, 1969, and was completed on January 21, 1970.

b. *The second delay claim period*

Plaintiffs were ready to drill their first well from Platform Hillhouse on April 6, 1970. However, USGS did not grant plaintiffs' approval to commence drilling until May 18, 1970. Plaintiffs seek delay damages for this 42-day period on the ground defendant's refusal to approve their drilling request on April 6, 1970, was unreasonable. On this record it is concluded that defendant's actions in this regard were reasonable under the circumstances.

USGS refused to authorize plaintiffs to commence drilling on April 6, 1970, because plaintiffs did not have available pipeline facilities from well head to shore through which oil production could flow. Plaintiffs are correct in pointing out that neither the OCSL Act nor implementing regulations precluded drilling unless pipeline access to shore was available. Plaintiffs argue from this fact that Interior thereby exceeded its authority in requiring such pipeline access as a precondition to drilling.

As indicated earlier, the Secretary was under a duty and had a responsibility to protect the Channel environment during the course of the Federal lease program in the Channel. *See Gulf Oil Corp.* v. *Morton, supra.* Accordingly, in evaluating actions taken by the Secretary relative to Channel lease operations this duty and responsibility must be kept in mind.

In the plan of development which plaintiffs submitted for approval, plaintiffs advised that they would not commence any drilling until a pipeline to shore was available in order to relieve any unexpected pressure they might encounter while drilling. Indeed, in their April 21, 1969, meeting with their platform contractor, plaintiffs advised it would be necessary to have onshore producing facilities operational before drilling will be permitted. The Secretary approved this plan of development which made the availability of pipeline facilities a precondition to drilling. Under the circumstances, it was not unreasonable for the Secretary to require plaintiffs to abide by their own plan. *See Austin Co.* v. *United States,* 161 Ct. Cl. 76, 81, 314 F.2d 518, 520–21,

cert. denied, 375 U.S. 830 (1963).[32] After all, plaintiffs' plan of development had been given careful consideration and found environmentally and technically safe. It would not be prudent to abandon part of that plan without further careful consideration. There was a safety feature associated with the pipeline precondition which Interior obviously could not ignore. If drilling produced a surge of oil for which no pipeline outlet was available, the pent-up pressure might result in further oil spills or seepage from below surface fractures and fissures. Plaintiffs recognized this possibility in their plan of development.

Plaintiffs during this period sought to obtain pipeline to shore facilities. Defendant worked with plaintiffs in this regard.[33] While not clearly set forth in the record, it is reasonable to assume that Interior gave careful consideration to plaintiffs' request that it be allowed to deviate from their plan of development and drill before pipeline facilities were available. This required a determination that such drilling could be done safely without a possibility of pressure reaction. In allowing plaintiffs to drill without available pipeline facilities on May 18, 1970, defendant ostensibly made this determination on the basis of a thorough review of existing conditions. On the totality of the record, the actions of defendant during the period cannot be viewed as unreasonable. Plaintiffs have failed to carry their burden of proving by a preponderance of the

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[32] The record is clear that pipeline facilities were not available on April 6, 1970. Indeed, such facilities were not available until July 21, 1970. Whether onshore facilities would, in fact, have been available to plaintiffs by April 6, 1970, is unclear on this record. It is clear that onshore facilities were available to plaintiffs on July 21, 1970.

[33] The California State Lands Commission refused to act on plaintiffs' request to construct a pipeline across state lands within the 3-mile limit. Interior suggested that plaintiffs write the Commission informing them that Interior had authorized them to drill on their tract and that this permission was granted in accordance with the recommendations of the DuBridge Committee that drilling take place in the Dos Cuadras field to relieve pressure. Interior further advised that after plaintiffs sent such a letter to the Commission, Interior would authorize plaintiffs to drill without pipeline facilities being available to them. Plaintiffs wrote such a letter to the State Lands Commission, and Interior thereafter, on May 18, 1970, allowed plaintiffs to drill without pipeline facilities. Ostensibly, Interior felt that State Lands Commission's authorization would be forthcoming if they knew Interior was going to allow drilling to commence and that hopefully pipeline facilities would shortly be available.

evidence that defendant's actions during the period April 6, 1970 - May 18, 1970, were unreasonable, unjustified or otherwise arbitrary.

c. The third delay claim period

The first well on Platform Hillhouse was completed and ready to produce on June 16, 1970. However, plaintiffs did not commence oil and gas production from Platform Hillhouse until July 21, 1970. Plaintiffs seek delay damages for this 35-day period on the ground that defendant's failure to order cooperative development of Union Oil's Tract 402 and plaintiffs' Tract 401 on or before June 16, 1970, unreasonably delayed plaintiffs' production efforts. Plaintiffs' contentions, on this record, are found to be without merit.

While plaintiffs were ready to produce oil and gas on June 16, 1970, no pipeline facilities to shore were available for transportation of said production. There were two alternatives open to plaintiffs relative to pipeline facilities to shore. First, they could construct their own pipeline from Platform Hillhouse to shore. However, this meant crossing state and county submerged lands, and the California State Lands Commission refused to act on plaintiffs' request for permission to construct a pipeline across state lands, and the County of Santa Barbara refused to permit plaintiffs to build such a pipeline across county trust lands. Second, since Union Oil already had a pipeline running from their Platform A to shore, plaintiffs could construct a pipeline from Platform Hillhouse to Platform A and thereafter utilize Union Oil's pipeline to shore facilities. Plaintiffs, therefore, were forced under the circumstances to concentrate on the second alternative.

On March 19, 1970, Union Oil and plaintiffs ostensibly reached an agreement whereby Union Oil assigned 30 percent of its pipeline to shore facilities to plaintiffs. In anticipation of such use, plaintiffs completed construction on April 2, 1970, of a pipeline between Platform Hillhouse and Union Oil's Platform A. However, this assignment agreement between Union Oil and plaintiffs was contingent on the State Lands Commission approving said

assignment in accordance with the terms of the Commission's right-of-way pipeline lease to Union Oil. By May 26, 1970, Union Oil had taken the position that it could not accept, in any event, production oil from plaintiffs' Tract 401 for transportation to shore in the absence either of approval by the State Lands Commission and/or a special order from Interior.

It is important to note that the second alternative available to plaintiffs also involved the State Lands Commission since Union Oil's pipeline crossed state submerged lands, and that Union Oil's pipeline to shore was subject to a right-of-way lease agreement between the state and Union Oil. More importantly, Union Oil's agreement with the state required, in the eyes of Union Oil and the state, state approval for any assignment or use of these pipeline facilities to other parties. The state was not disposed, initially, to allow plaintiffs, by assignment or otherwise, to utilize Union Oil's pipeline to shore for production purposes.[34]

Plaintiffs concede that the above impediments to oil and gas production existed. They contend, however, that defendant's failure to issue a directive to Union Oil on June 16, 1970, compelling Union Oil to carry plaintiffs' production through Union Oil's pipeline to shore primarily delayed its production efforts.[35] In support of this conten-

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[34] In an effort to obviate, if possible, the need to obtain state approval for the assignment worked out with Union Oil, plaintiffs sought, on June 5, 1970, to have defendant issue an order of cooperative development, pursuant to its power under section 2(c) of its standard lease agreement with Union Oil, directing and requiring Union Oil to transport plaintiffs' oil through its existing pipeline. Plaintiffs believed that if such an order were issued, state approval of Union Oil's assignment would not be necessary. However, the State Lands Commission did not view the Union Oil pipeline agreement with the state that way and, while not crystal clear in the record, it would appear Union Oil did not view its lease agreement with the state that way.

[35] As indicated previously, Union Oil would not accept plaintiffs' production unless, *inter alia*, the State Lands Commission approved the pipeline assignment and/or Interior issued a special order directing it to do so. Plaintiffs' theory herein ostensibly is that a directive from Interior would supersede any state action prohibiting Union Oil from breaching its pipeline lease agreement by assignment use of said pipeline to plaintiffs. Such a situation, if confrontation became an actuality, could give rise to a serious federal-state question under the Tenth Amendment to the United States Constitution. Fortunately, there is no need to determine whether or not the OCSL Act gave authority to the Secretary to abridge contractual rights of the state, under the circumstances, since the state did approve the assignment on July 21, 1970.

tion plaintiffs stress that defendant was under an implied duty to do "whatever is necessary to enable [plaintiffs] to perform," citing *Kehm Corp.* v. *United States*, 119 Ct. Cl. 454, 469, 93 F. Supp. 620, 623 (1950). However, that case also states: "The implication [implied duty] is sometimes defeated by circumstances."

Plaintiffs' implied duty theory springs from section 2(c) of the standard OCSL Act lease, which section was to be found in both Union Oil's lease and in plaintiffs' lease. (*See* text, *ante* at 728–29.) That section empowers the Secretary to require lessees operating in the same oil field to "operate under such reasonable cooperate * * * plan for the development and operation of the * * * field * * * as the Secretary may determine to be practicable and necessary or advisable in the interest of conservation *which plan shall adequately protect the rights of all parties in interest, including the United States.*" (Emphasis added.)

The language of section 2(c), *supra*, manifests discretion in the Secretary, not a legal duty. The real question here is whether defendant acted so unreasonably as to require a finding that discretionary authority was exercised arbitrarily. The facts support a finding of reasonable actions by Interior under the circumstances.

On June 5, 1970, plaintiffs requested USGS to issue an order requiring Union Oil to accept plaintiffs' oil and gas production for transmittal to shore facilities. At plaintiffs' request a conference between representatives of Union Oil, Interior and plaintiffs was held on June 15 and 16, 1970, to discuss the matter. The position of Interior was that it would approve any cooperative agreement reached by plaintiffs and Union Oil and urged the companies to reach an agreement. However, the companies were unable to reach any agreement on the matter at the June 15 - 16 conference. The record does not disclose what all the specific disagreements were between Union Oil and plaintiffs. The record does suggest that these disagreements embraced more than Union Oil's concern over its pipeline lease agreement with the State Lands Commission that no pipeline assignment use would be made by Union Oil without Commission approval. Plaintiffs again requested Interior to issue a cooperative directive whereby Union

Oil's pipeline would have to carry plaintiffs' production to shore.[36]

The record is unclear as to all the maneuvering that took place between June 16, 1970, and July 21, 1970. However, an inference is warranted that Interior put forth good faith efforts during this period to resolve the matter. First, USGS obtained authority from the Secretary to direct that both Union Oil and plaintiffs develop their tracts on a cooperative basis, that Union Oil transport plaintiffs' oil to shore in the Union Oil pipeline, and that Union Oil and plaintiffs work out the details themselves. This directive was sent to plaintiffs and Union Oil on July 21, 1970, and production by plaintiff commenced that day. Coincidentally, the State Lands Commission held a meeting on July 21, 1970, and authorized Union Oil's assignment of its pipeline to plaintiffs. The record suggests, by inference, that activities by Interior, behind the scene, was responsible in some measure for this harmonious resolution of a rather touchy problem. The fact that the State Lands Commission granted approval on the very same day that Interior directed cooperation between the companies suggests more than coincidence. It suggests spade work by a concerned party - Interior.

Plaintiffs argue strenuously that any cooperative directive by Interior would automatically entitle plaintiffs to utilize Union Oil's pipeline and that State Lands Commission approval would not be required. There is no probative evidence supporting this view in the record and, as a matter of law, such a legal position is open to question. Moreover, it is quite possible that had such a cooperative directive been issued on June 16, 1970, and had Union Oil

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[36] It was not unreasonable for Interior to try and encourage voluntary cooperation between competitive oil companies before resorting to the ultimatum approach of directing unwilling competitors to cooperate. Section 2(c) of the standard OCSL Act lease authorized the Secretary to resort to cooperative plans, in his discretion, but that he was to "protect the rights of all parties in interest." Plaintiffs were not to be favored at the expense of Union Oil and vice versa. Interior's approach to the matter was reasonable and proper. Moreover, the cooperative directive that was ultimately issued still required plaintiffs and Union Oil to work out the details. This written directive was a manifestation of Interior's efforts prior to July 21, 1970, to get the parties to work out the details for an agreement which Interior advised it would accept. The delay, in these circumstances, seems more properly to lie with the oil companies than with Interior. Interior cannot be faulted for delay in this regard.

begun to transport plaintiffs' oil production through its pipeline, the state may have engaged in legal proceedings on the matter (*see* text and n.13, *supra*) which might have delayed plaintiffs' production date beyond July 21, 1970.[37] On this record, it would appear that between June 16 and July 21, the state was persuaded to cooperate by granting approval to the pipeline assignment.

The evidence of record does not preponderate in favor of a finding that had Interior directed Union Oil to accept plaintiffs' oil production on June 16, 1970, plaintiffs would have been able to produce and transport their oil to shore through Union Oil's pipeline. There is too much uncertainty on this record to make such a finding. The record, also, will not support a finding that defendant's actions during the period June 16, 1970 - July 21, 1970, were unreasonable under the circumstances.

The record as a whole will not support a finding that defendant's actions or inactions during the period April 25, 1969 - July 21, 1970, were unreasonable, unjustified, or arbitrary. As a result, plaintiffs' claim for 112 days of delay damages must be denied.[38]

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[37] Moreover, this record does not establish that Union Oil would have abided by such a directive if the State Lands Commission had emphasized its objections and called attention to Union Oil's lease obligations not to assign use of its pipeline without Commission approval. On this record, it seems clear that both Union Oil and the State Lands Commission read their pipeline lease agreement as prohibiting any pipeline assignment use unless Commission approval was given. There is no evidence, nor is there any reasonable suggestion, in the record, that Interior had any control over or any manner of privity with the State Lands Commission. *See Edison Sault Electric Co.* v. *United States*, 213 Ct. Cl. 309, 321–22, 552 F.2d 326, 333 (1977); *see also L. L. Hall Constr. Co.* v. *United States*, 177 Ct. Cl. 870, 878–79, 379 F.2d 559, 563–64 (1966).

[38] Defendant maintains that, in any event, plaintiffs have waived their right to claim any breaches of the lease contract herein because, after knowledge of defendant's breaches, they elected to continue performance. It relies on *Ling-Temco-Vought, Inc.* v. *United States*, 201 Ct. Cl. 135, 145–50, 475 F.2d 630, 636–39 (1973) and other cases in support of this position. *See also Cities Service Helex, Inc.* v. *United States*, 211 Ct. Cl. 222, 543 F.2d 1306 (1976). Without elaboration, close analysis of the cases cited by defendant reveal that they rest on circumstances much different from those present in this case. The instant case is deemed to involve particular circumstances which allow for continued performance by plaintiffs without waiver of their right to sue for damages for partial breaches of the lease contract by defendant. The parties do not seem to regard the alleged breaches as material enough to have justified termination of the lease. Moreover, under the lease, continued performance by plaintiffs would seem to serve to mitigate damages rather than run up damages. Finally, plaintiffs paid $38,380,032 for the lease rights to drill for and produce oil and gas from defendant's land. Plaintiffs' leasehold rights permit them to continue

Platform Henry

Plaintiffs proposed to develop the east side of Tract 401, in the Carpinteria oil and gas fields, by the installation of Platform Henry.

On December 29, 1969, plaintiffs submitted their plan of development for the east side of Tract 401 for approval, and on January 22, 1970, they applied for a permit to install Platform Henry. Public hearings were subsequently held on plaintiffs' permit application and thereafter a draft Environmental Statement on said application was prepared and made available for public comment.[39] The Final Environmental Statement was submitted to Secretary of Interior, Rogers C. B. Morton, on August 23, 1971. Secretary Morton denied plaintiffs' plan and permit applications on September 20, 1971, and amplified that denial with a "Statement of Decision" which he issued on November 3, 1972.

a. *Breach of contract*

In challenging Secretary Morton's denial of their permit application, plaintiffs present three arguments in support of their contention that defendant breached the lease contract.

First, plaintiffs maintain that political considerations were the primary cause of the denial and this fact serves to render said denial unlawful and improper. If plaintiffs were correct in their factual assertions, this contention would have some merit. *See D.C. Federation of Civic Associations* v. *Volpe*, 459 F.2d 1231, 1246 (D.C. Cir. 1971), *cert. denied*, 405 U.S. 1030 (1972); *Center on Corporate*

exercising those rights and also to seek damages for any interferences by defendant with the exercise of those rights. *See Northern Helex Co.* v. *United States*, 197 Ct. Cl. 118, 124–31, 455 F.2d 546, 550–54 (1972). *See also Meva Corp.* v. *United States*, 206 Ct. Cl. 203, 218, 511 F.2d 548, 557 (1975). *See generally* 5 WILLISTON, CONTRACTS §§ 683–88 (3d ed. 1961).

[39] The Environmental Statement was required by the National Environmental Policy Act of 1969, 83 Stat. 852, 42 U.S.C. § 4331, (1970) (NEPA). This requirement did not exist when the installation of Platform Hillhouse was under consideration. NEPA is an "environmental full disclosure law" which seeks to assure that potential environmental impacts are subject to thorough study and a detailed statement. *See Monroe County Conservation Council, Inc.* v. *Volpe*, 472 F.2d 693, 696–99 (2d Cir. 1972).

Responsibility, Inc. v. *Schultz*, 368 F. Supp. 863 (D.D.C. 1973). However, this record will not factually support such a contention.

The record indicates that Secretary Morton did seek guidance from the White House relative to plaintiffs' Platform Henry application, as well as Union Oil's Platform C application. However, in requesting White House views on these matters, Secretary Morton advised that he was not disposed to grant these permits. Touching base with the White House, in itself, was not unusual given the public interest in and concern about the environment in the Santa Barbara Channel. As a cabinet officer, it would seem that Secretary Morton had an obligation to keep the White House informed relative to matters of such public importance and to advise what course of action he intended to pursue. The record further reflects that personnel in the White House considered the political and legal pros and cons of alternative actions which could be taken on the matter. However, there is not enough reliable evidence in the record to preponderate in favor of a finding that political considerations, in fact, were significantly responsible for the denial action taken relative to Platform Henry.

As its second argument, and in essence connected with the first argument above, plaintiffs maintain that Secretary Morton did not make the decision denying Platform Henry's permit application but that, in fact, said decision was made by President Nixon.[40] Plaintiffs see this as a violation of the holding in *New York Shipbuilding Corp.* v. *United States*, 180 Ct. Cl. 446, 457–61, 385 F.2d 427, 433–36 (1967), and sufficient to require that the denial action be deemed improper and thus a breach of the lease agreement.

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[40] Plaintiffs' evidence in this regard consists of a newspaper account of remarks made by President Nixon wherein he was quoted as saying that he made the decision to deny the Platform Henry permit and Secretary Morton made the announcement of said denial. This same newspaper account, however, quoted Secretary Morton as saying that he made the decision to deny the permit after consultation with White House staff members. As indicated previously, there was no testimonial evidence in this record. *See Sun Oil Co.* v. *United States*, 206 Ct. Cl. 742, 752, 514 F.2d 1020, 1025 (1975).

The thrust of plaintiffs' second argument is that, under the lease they were entitled to have decisions on Platform Henry made by the Secretary and not the President of the United States. The extent to which a President may permissibly direct the actions of his subordinate in the administration of contract matters is a most troublesome question. *Compare Marbury* v. *Madison*, 5 U.S. 137, 170 (1803) and *Kendall* v. *United States*, 37 U.S. 524, 610 (1838); *with Congress Constr. Corp.* v. *United States*, 161 Ct. Cl. 50, 55–56, 314 F.2d 527, 530–31, *cert. denied*, 375 U.S. 817 (1963). The circumstances herein would require a careful appraisal of the holding of *New York Shipbuilding Corp.* v. *United States*, *supra*,[41] if it were necessary to confront this question. Fortunately, this question can be pretermitted because of the absence of any necessary factual predicates.

The record in this case does not establish with any degree of reliability that President Nixon and not Secretary Morton made the decision to deny the Platform Henry permit. The record does indicate that Secretary Morton was disposed to deny the permit before he sought White House guidance. The more acceptable view, on this record, is that the White House agreed with Secretary Morton's decision to deny the permit and not that it directed such a denial or that President Nixon made the ultimate decision. In any event, there is a presumption, as indicated earlier (*see ante* at 745–46), that Secretary Morton properly performed his duties and that the decision denying the Platform Henry permit reflected his judgment on the matter. *See Pacific Architects and Engineers, Inc.* v. *United States*, 203 Ct. Cl. 499, 516–20, 491 F.2d 734, 744–46 (1974).

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[41] In this case, the court held "that a contractor is entitled to a finding by the contractually-agreed officer [Nuclear Projects Officer of the Maritime Administration] and that a decision by someone else [Chief, Office of Research and Development of the Maritime Administration] is a nullity" (180 Ct. Cl. at 461, 385 F.2d at 436). More importantly, the consequences of such improper action in the *New York Shipbuilding Corp.* case was not a liability determination that the contractor receive damages because the decision was made by one not contractually agreed upon, but that the merits of the contractor's claims be tried in the court without recourse to the administrative determination. (180 Ct. Cl. at 461–62, 385 F.2d at 436–37). Accordingly, it is questionable, in any event, whether the holding of the *New York Shipbuilding Corp.* case would support a liability determination in plaintiffs' favor. Such a determination would have to be reached on the merits of the case. This is what is done hereinafter.

Whether that judgment was right or wrong is another question. The presumption referred to above is not rebutted by conflicting newspaper accounts as to who made the definitive decision on the permit denial.

Plaintiffs' third and primary argument is that denial of the Platform Henry permit application was unjustified on the merits and in breach of the lease agreement. The record supports such a contention.

It is established that plaintiffs' plan of development for the east side of Tract 401 and its permit application for installation of Platform Henry complied with all applicable OCSL rules, regulations, and orders. It is further established that all subordinate officials of the Secretary recommended that he grant the permit to install Platform Henry. More importantly, the 1971 Final Environmental Statement found, *inter alia*, that Platform Henry was required in order to complete development of the Carpinteria oil and gas field since existing platforms (those of the Phillips group) would not permit complete recovery of reserves. This 1971 Final Environmental Statement found no conservation, environmental or other impediment to the granting of the permit to install Platform Henry. In the face of the above undisputed facts, the Secretary denied plaintiffs' permit to install Platform Henry. The question to be decided herein is whether the Secretary's denial was authorized and justified by the OCSL Act and implementing regulations, *i.e.*, would the installation of Platform Henry on or about September 20, 1971, pose a threat of harm to the Channel environment. If not, then the Secretary must be deemed to have breached the lease agreement which gave plaintiffs a clear right to install Platform Henry.

As indicated previously, the Secretary has broad powers and considerable authority to control lease operations in the Channel area on OCSL. However, that power and authority is not absolute. The Secretary has a duty and a responsibility to protect the Channel environment. However, he cannot breach vested contractual rights under the guise of protecting the Channel environment, if the exercise of those contractual rights pose no threat to the Channel environment. Conversely, the plaintiffs do not

have an absolute right under their lease to conduct Channel operations when, where, and how they please. Plaintiffs are subject to reasonable restraints on their lease rights when such restraints are based on sound environmental and/or conservation grounds. *Union Oil Company of California* v. *Morton, supra,* 512 F.2d at 750–52; *Gulf Oil Corp.* v. *Morton, supra,* 493 F.2d at 149–50.

Defendant argues that plaintiffs' right to develop the east side of Tract 401 has only been temporarily suspended. If this is so, justification must be found for the Secretary's authority to suspend lease operations.

Section 5(a)(1) of the OCSL Act, authorized the Secretary to issue regulations which would provide, *inter alia,* "* * * in the interest of conservation, for * * * suspension of operations or production * * *." This is the only language in the OCSL Act dealing with the Secretary's power to suspend lease obligations in the Channel. The above language, however, has been viewed broadly and has been held to encompass environmental as well as conservation reasons. *See Gulf Oil Corp.* v. *Morton, supra.*

The Secretary, as authorized by the OCSL Act, amended existing regulations on August 22, 1969,[42] to provide that a lessee's operations may be suspended if that operation:

> * * * threatens immediate, serious, or irreparable harm or damage to life, including aquatic life, to property, to the leased deposits, to other valuable mineral deposits or to the environment. Such emergency suspension shall continue until in his [the Secretary's] judgment the threat or danger has terminated. [30 C.F.R. § 250.12(c).]

Whether the denial action by the Secretary is viewed as a temporary suspension or as a denial for an indefinite period of time,[43] the validity of the denial action must be

[42] Section 5(a)(1) of the OCSL Act empowered the Secretary to amend existing rules and regulations whenever he deemed it necessary for conservation of natural resources. Thus regulations adopted after the lease was entered into were binding on the parties. *See Union Oil Company of California* v. *Morton, supra,* 512 F.2d at 748–49. *See also Edison Sault Electric Co.* v. *United States, supra,* 213 Ct. Cl. at 309, 552 F.2d at 336.

[43] While the plan of development and application for an installation permit for Platform Henry had not been granted as of the closing of proof in this case, the activities of the parties relative to development of the east side of Tract 401 indicate that the lease agreement between them as to said east side is existing, valid and binding. The drilling of exploratory wells on the east side in 1976 and 1977 suggests

considered in the light of the OCSL Act and implementing regulations discussed above. The denial action of the Secretary must be examined to see if such action was justified on the grounds that installation of Platform Henry would be contrary to "the interest of conservation" and would pose "an immediate, serious or irreparable harm or damage to life, including aquatic life * * * or to the environment."

In his decision of September 20, 1971, Secretary Morton denied the Platform Henry installation permit "because of overriding environmental conditions." No such conditions were set forth in this terse decision. In a contemporaneous news release, Secretary Morton stated that Platform Henry was not approved because "new platforms to be installed on Federal leases seaward of the State Sanctuary are incompatible with the concept of the Federal Sanctuary" embodied in proposed legislation submitted to Congress on April 21, 1971.[44]

This cursory denial by Secretary Morton of plaintiffs' installation permit for Platform Henry on September 20, 1971, was made despite favorable recommendations from all subordinate officials in Interior. It was made in the face of the August 23, 1971, Final Environmental Statement, which was submitted to the Secretary but was ignored in his denial decision. This Statement failed to find that installation of Platform Henry would be contrary to the interest of conservation, nor did this Statement find that said installation would pose a threat or cause irreparable harm to the Channel environment. The 1971 Final Environmental Statement, which endorses installation of Platform Henry by force of language and reasoning, does not justify denial of plaintiffs' permit application without more substantial conservation and/or environmental reasons than those advanced by the Secretary in his decisional letter of September 20, 1971.[45]

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that the denial here in issue was not permanent but temporary.

[44] This reason seemed "illogical" to White House personnel, an observation of considerable merit, since plaintiffs' Tract 401 was specifically exempted from the Federal Sanctuary legislation which Interior proposed for congressional consideration and approval.

[45] The favorable conclusions supporting installation of Platform Henry set forth in the 1971 Final Environmental Statement were reaffirmed by USGS in its 1976 Final

Over a year later, on November 3, 1972, Secretary Morton issued a Statement of Decision wherein he listed the primary factors that led to his September 20, 1971, decision denying the Platform Henry permit application. In circumstances such as this, the Supreme Court has cautioned that, "[s]uch an explanation will, to some extent, be a 'post hoc rationalization' and thus must be viewed critically." *Citizens to Preserve Overton Park, Inc.* v. *Volpe*, 401 U.S. 402, 420 (1971). It should be noted that this same Statement of Decision also was applicable to Union Oil's Platform C and was the subject of decision by the Ninth Circuit in *Union Oil Company of California* v. *Morton*, *supra*. These factors, as stated by the Secretary, were as follows:

(1) construction of the proposed platform and drilling wells would increase the risk of oil pollution in the Santa Barbara Channel by reason of:

(a) the risks inherent in offshore oil drilling;
(b) location of the Channel in an active seismic belt; and
(c) with regard to Platform "C", the fact that the platform would be located on the damaged Dos Quadros [sic] structure;

(2) oil pollution in the Santa Barbara Channel would have adverse consequences, both short and longer term, because of the characteristics of the Channel environment; the following attributes of the Channel that would be affected by oil pollution were given particular consideration:

(a) animal and plant marine life;
(b) commercial and sport fisheries;
(c) recreational use;
(d) beaches and shore line of the Channel;
(e) birds;

(3) the lack of systems and equipment which are completely effective in controlling and removing oil pollution under all weather and sea conditions;

Environmental Statement, Oil and Gas Development in the Santa Barbara Channel Outer Continental Shelf off California. This Statement, issued on March 4, 1976, concluded that installation of Platform Henry would involve no different environmental impacts than would be found in any offshore drilling in the Santa Barbara Channel and would pose no unique risks or threats to the Channel environment.

(4) the suitability of the Dos Quadros [sic] structure (leases OCS-P 0241 and 0240) for unitization and the suitability of leases OCS-P 0240 and 0166 for unitization;[46]
(5) additional platforms would increase interference with other uses of the Channel for recreational and commercial fishing;
(6) additional platforms would be aesthetically undesirable.

With respect to factors (2), (4), (5) and (6) there is no question but that these factors were known and undoubtedly considered when the lease was entered into. Accordingly, denial of the Platform Henry permit for these factor reasons was both unjustified and unreasonable. I agree with the Ninth Circuit in this regard. *See Union Oil Company of California* v. *Morton, supra,* 512 F.2d at 751; *see also United States Trust Co. of New York* v. *New Jersey,* 431 U.S. 1 (1977). As to factors (1) and (3), the Ninth Circuit in *Union Oil Company of California* v. *Morton, supra,* felt that these two factors suggested conditions which the development of new technology or further studies may lessen as threats to the environment. Knowledge of such risks, the Ninth Circuit observed, might serve to support denial of the permit application. However, the Ninth Circuit emphasized that the November 3, 1972, Statement of Decision, standing alone, was insufficient to justify the Secretary's decision as matters then stood.[47] (512 F.2d at 751–52.)

The record in this case contains no evidence relative to factors (1) and (3), *supra,* which would indicate environmental risks unanticipated at the time the lease was executed.

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[46] Use of this factor reason by the Secretary is clearly unsupportable. The 1971 Environmental Statement on Platform Henry pointed out that unitization of leases OCS-P 0240 (plaintiffs' Tract 401) and OCS-P 0166 (Phillips Group's Tract 298) was not truly an alternative because maximum development of the Carpinteria field was not possible utilizing the Phillips Group's platform alone. As a result, installation of Platform Henry was necessary, contrary to the Secretary's implication, for maximum development of the Carpinteria oil and gas field.

[47] The record does not indicate that further proceedings were conducted in the *Union Oil Company of California* case in conformance with the decision of the Ninth Circuit. In light of the 1976 Final Environmental Statement it is not unreasonable to conclude that the suggested possible risk conditions, hypothesized by the Ninth Circuit, which might serve to justify the Secretary's denial decision did not exist in the Channel.

As a result, those factor reasons must also be considered unjustified and unreasonable. Moreover, subsequent to the Ninth Circuit decision in *Union Oil Company of California* v. *Morton, supra,* the 1976 Final Environmental Statement was issued, as indicated previously, which found no conservation, environmental or other impediment to installation of Platform Henry.

The record in this case discloses rather clearly that installation of Platform Henry did not pose a threat to the Channel environment nor would its installation be contrary to the interests of conservation. Under these circumstances, the denial by the Secretary loses the rationale necessary for its validity. Moreover, the denial is not justified by any authority which flows to the Secretary from the OCSL Act and implementing regulations. All the recommendations received by the Secretary favored granting the permit request. Two Final Environmental Statements favored the installation of Platform Henry. Nothing in this record supports the Secretary's denial decision. It must be concluded that denial of the plaintiffs' Platform Henry permit request on September 20, 1971, unreasonably interfered with and thereby breached plaintiffs' lease right to install such a platform. *See Neely* v. *United States, supra; Himfar* v. *United States,* 174 Ct. Cl. 209, 215–16, 355 F.2d 606, 610 (1966). *See also Peter Kiewit Sons' Co.* v. *United States,* 138 Ct. Cl. 668, 675, 151 F.Supp. 726, 731 (1957). Plaintiffs are entitled to recover delay damages until such time as defendant allows plaintiffs to install Platform Henry or until such time as defendant justifies on conservation and/or environmental grounds the "suspension," as defendant characterizes its actions, of Platform Henry installation efforts on the east side of plaintiffs' Tract 401.

The essence of defendant's position as to the installation permit for Platform Henry is that the Secretary's authority and responsibility under the OCSL Act and implementing regulations to protect the Channel environment from risk of harm was absolute enough to justify denial of the permit, regardless of whether the denial was unreasonable or unjustified. Such a broad position is untenable and

cannot be accepted. *See Union Oil Company of California* v. *Morton, supra.*

As a corollary to the above position, defendant also argues that the Secretary's action in denying the permit application constituted a sovereign act, the exercise of which does not give rise to any governmental liability, citing *United States* v. *Central Eureka Mining Co.*, 357 U.S. 155 (1958); *Glasgow Associates* v. *United States*, 203 Ct. 532, 495 F.2d 765 (1974); and other sovereign act cases. In each of the cases relied on by defendant, the governmental action complained of had public and general applicability, the usual touchstone for sovereign act applicability. *See Horowitz* v. *United States*, 267 U.S. 458, 460 (1925); *Wunderlich Contracting Co.* v. *United States*, 173 Ct. Cl. 180, 196, 351 F.2d 956, 967 (1965). In this case, however, the action taken by Secretary Morton in denying the Platform Henry permit, as well as the actions taken by Secretary Hickel with respect to Platform Hillhouse, were not actions of public and general applicability, but were actions directed principally and primarily at plaintiffs' contractual right to install a platform on Tract 401 and to extract oil and gas therefrom. The doctrine of sovereign immunity does not insulate defendant from liability in such instances. *Ottinger* v. *United States*, 116 Ct. Cl. 282, 285, 88 F.Supp. 881, 883 (1950).

b. *Fifth amendment taking*

The parties devote a large portion of their briefs to the question of whether or not the Secretary's denial of the Platform Henry permit constituted a partial taking[48] of plaintiffs' leasehold rights to install such a platform and to extract oil and gas from Tract 401.

Defendant seems to imply that because the west side of Tract 401 was producing oil and gas from Platform Hillhouse, this production effort serves to preclude any taking claim as to development of the east side of Tract 401. However, partial takings are not strange animals in

[48] Since the parties by their actions believe that the lease is viable as to development of the east side of Tract 401, a permanent taking at this time has not occurred in any event.

the law of federal eminent domain. *See United States* v. *General Motors Corp.*, 323 U.S. 373, 378 (1945).

It is difficult to discern from plaintiffs' briefs whether they present their taking claim as an independent and additional claim or whether said claim is an alternative claim. The petition of plaintiff Marathon Oil describes the taking claim as an alternative claim. Since plaintiffs would only be entitled to one recovery from the permit denial, it would seem that the taking claim is an alternative claim to the breach of lease contract claim. Therefore, recovery on one claim theory would seem to preclude recovery on the other claim theory. Recovery on the breach of lease contract claim has been allowed herein. However, because of the importance which the parties seem to place on the taking aspects of the Secretary's actions, the taking claim theory deserves consideration and discussion.

As a general proposition, a leasehold interest is property, the taking of which entitles the leaseholder to just compensation for the value thereof. *Lemmons* v. *United States*, 204 Ct. Cl. 404, 421, 496 F.2d 864, 873 (1974). Further, authorized governmental actions can entail such an actual invasion of property rights that a constitutional taking can be implied. *Eyherabide* v. *United States*, 170 Ct. Cl. 598, 601, 345 F.2d 565, 567 (1965), and cases cited therein. *See also Benenson* v. *United States*, 212 Ct. Cl. 375, 548 F.2d 939 (1977). The fact that a taking is temporary, as contrasted with a permanent taking, is of no consequence in the law of federal eminent domain. *R. J. Widen Co.* v. *United States*, 174 Ct. Cl. 1020, 1032, 357 F.2d 988, 996 (1966), and cases cited therein. Eminent domain (taking of property) is to be distinguished from police power (regulation of property). However, if regulation is unreasonable or arbitrary relative to private property rights, the law of eminent domain applies. *See Goldblatt* v. *Town of Hempstead*, 369 U.S. 590, 594 (1962); *Pennsylvania Coal Co.* v. *Mahon*, 260 U.S. 393, 413–14 (1922).

It is established that not every deprivation of use, possession, or control of property is a taking. One must look to the character and extent of any interference with property rights whenever a taking claim is asserted. *Finks* v. *United States*, 184 Ct. Cl. 480, 489, 395 F.2d 999, 1004,

cert. denied, 393 U.S. 960 (1968); *see generally* 2 *Nichol's Eminent Domain,* § 6.1 (rev. 3d ed. 1976). More importantly, the concept of a taking as a compensable claim theory has limited application to the relative rights of party litigants when those rights have been voluntarily created by contract. *See J. J. Henry Co.* v. *United States,* 188 Ct. Cl. 39, 46, 411 F.2d 1246, 1249 (1969). In such instances, interference with such contractual rights generally gives rise to a breach claim not a taking claim.

Plaintiffs and defendant entered into a lease agreement which set forth the rights and obligations of the parties conditioned only by the OCSL Act and implementing regulations. It has been said that when defendant "comes down from its position of sovereignty and enters the domain of commerce, it submits itself to the same laws that govern individuals there." *Cooke* v. *United States,* 91 U.S. 389, 398 (1875); *see also Perry* v. *United States,* 294 U.S. 330, 352 (1935). Defendant's lease operations in the Channel, therefore, more properly, represent activity by it in a proprietary capacity rather than a sovereign capacity. Accordingly, under the lease contract with plaintiffs, defendant obtained certain rights and incurred certain responsibilities as did plaintiffs. Remedies for violation of any of their lease rights by plaintiffs must be directed at defendant in its proprietary capacity and not in its sovereign capacity.

Before a taking can be established, it must be clear that there was an intent by defendant to take private property. Such an intent can be implied from the facts. *See Lemmons* v. *United States, supra,* 204 Ct. Cl. at 414, n.5, 496 F.2d at 869, n.5. On this record, and under the circumstances of the Union Oil blow out and its fearful and uncertain aftermath, it is difficult to discern an intent on the part of defendant to take temporarily plaintiffs' property. The interferences with plaintiffs' lease rights were grounded on matters that, at times material herein, bespoke an effort to operate within the framework of the lease and applicable regulations, not to take plaintiffs' property rights. If defendant's interferences were unjustified or unreasonable, plaintiffs' rights emanate from the lease agreement, not the Fifth Amendment.

Finally, the actions of the government representative on which a taking claim is premised must be authorized either expressly or by necessary implication, by some valid enactment of Congress. *United States* v. *North American Transp. & Trading Co.*, 253 U.S. 330, 333 (1920); *Hooe* v. *United States*, 218 U.S. 322, 335–36 (1910). *See Youngstown Sheet & Tube Co.* v. *Sawyer*, 343 U.S. 579 (1952).[49] The only language in the OCSL Act which expressly authorizes the Secretary to take plaintiffs' lease rights is to be found in 43 U.S.C. § 1341(c) where, in special national emergency or state of war situations, the Secretary is authorized to suspend lease operations and to pay just compensation to the lessee whose operations are suspended. No such situations are present in this case. The Ninth Circuit, when confronted with the issue of whether Secretary Morton's denial on September 20, 1971, as amplified on November 3, 1972, of Union Oil's request for a permit to install Platform C on the Dos Cuadras field constituted a taking, held:

> Congress' clear concern to distinguish police power regulation from invasion of property rights in these leases convinces us that Congress did not confer powers of condemnation upon the Secretary by implication.
>
> * * * * *
>
> * * * Such a taking by interference with private property rights is within the constitutional power of Congress, subject to payment of compensation * * *. But Congress no more impliedly authorized the Secretary to take the leasehold by prohibiting its beneficial use than by condemnation proceedings. A suspension for which the fifth amendment would require compensation is therefore unauthorized and beyond the Secretary's power. [*Union Oil Company of California* v. *Morton*, *supra*, 512 F.2d at 750–51.][50]

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[49] In *Lynch* v. *United States*, 292 U.S. 571, 579 (1934), relied on by plaintiffs, it was stated: "* * * Rights against the United States arising out of a contract with it are protected by the Fifth amendment." The significant fact in the *Lynch* case is that *congressional* action abrogated the contracts in issue thereby giving rise to a taking by authorized governmental action. Interference by Congress, and not the Secretary, with plaintiffs' contractual rights is a necessary predicate for finding a valid taking claim here.

[50] In other portions of its opinion following after the quoted portions set out above, the Ninth Circuit used the verb "take" in alluding to Secretarial action. Such a use, if it is viewed as implying a possible compensable Fifth Amendment taking by Secretarial action alone, is inconsistent and in conflict with the quoted portions of

Plaintiffs' briefs, while alluding to this holding of the Ninth Circuit, fail to persuade that said holding is erroneous as a matter of law. I believe the Ninth Circuit was correct in its holding that the Secretary was without authority to take an OCSL Act lessee's leasehold rights.

For the above reasons, it is concluded that the Secretary's denial on September 20, 1971, of plaintiffs' application to install Platform Henry on the east side of Tract 401 did not constitute a partial taking of plaintiffs' leasehold rights.

CONCLUSION OF LAW

Upon the findings of fact and the foregoing opinion, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that plaintiffs are not entitled to any recovery relative to the installation of Platform Hillhouse on the west side of Tract 401 under their lease with defendant and their petitions in this regard are dismissed; the court further concludes as a matter of law that plaintiffs are entitled to recover damages for defendant's breach of plaintiffs' lease rights relative to installation of Platform Henry on the east side of Tract 401, and judgment is entered to that effect, with the determination of the exact amount of recovery to be made in further proceedings under Rule 131(c). Plaintiffs' petitions setting forth an alternative taking theory of recovery relative to installation of Platform Henry are accordingly dismissed.

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the Ninth Circuit opinion, *supra*. However, in the context of the total opinion, no inconsistency or conflict arises if one reads the opinion as holding that Secretarial action, adopted by the Congress or inducing Congress to cancel the lease, can result in a compensable Fifth Amendment taking; but that Secretarial action alone can only result in a compensable damage claim by way of a breach of the lease contract. Such a reading would give consistency to the holding that the Secretary acting alone had no authority to take plaintiffs' property for purposes of a Fifth Amendment just compensation award.

Syllabus

573 F.2d 42

CHARLES E. PARKER, MARILYN E. PARKER, ROBERT I. MEYER AND JANE M. MEYER v. THE UNITED STATES

[No. 79–72. Decided February 22, 1978. Plaintiffs' motion for retrial and rehearing denied May 26, 1978]

ON THE PROOFS

Taxes; income tax; taxable income; proceeds of compromise of estate litigation; deductibility of attorney's fees.—Plaintiffs, brother and sister, seek refund of Federal income tax deficiencies, plus statutory interest, paid for calendar year 1965 arising out of a compromise settlement of $175,000 received by each for their interests as excluded heirs of their grandmother's estate as to which there had been no formal administration. They claimed in quiet title proceedings that they had been improperly excluded from sharing in the estate, and demanded a judgment declaring them owners of certain property interests allegedly held by their grandmother, as well as an award of compensatory and punitive damages for lost enjoyment and fraudulent concealment. The Internal Revenue Service determined that the compromise resulted in the sale or exchange of a capital asset, namely their claim against the estate, that a substantial amount of capital gain, attributable to appreciation of the claim over the years it remained unasserted, was thereby realized, and that this gain amounted to 75% of the settlement proceeds. Upon disallowance of their refund claim, plaintiffs filed the present suit, asserting entitlement to an exclusion from taxable income of the entire compromise proceeds as a tax-free "inheritance" within the meaning of Sec. 102(a) of the Code as interpreted in *Lyeth* v. *Hoey*, 305 U.S. 188 (1938). Plaintiffs agreed in the compromise that their allegations of fraudulent concealment were untrue and without merit, so no allocation of the proceeds respecting punitive damages is made. It is *held* (1) that plaintiffs were liable for tax at ordinary income rates of the claimed compensatory damages for lost income since those damages were in lieu of ordinary income not excludable from taxable income under Sec. 102; that that portion of the proceeds received by reason of heirship based on the 1944 valuation was excludable from taxable income; and that the balance of the proceeds received in lieu of the appreciated value of the land since 1944 was taxable as gain on exchange of a capital asset; (2) that the portion of attorney's fees attributable to the claim of lost income taxable as ordinary income is deductible under Sec. 212; and that attorney's fees incurred in the acquisition of money attributable to the appreciated real estate interests are allowable as an adjustment to basis under Sec. 1016; and (3) that since the aforesaid allocation of the proceeds shows that

Syllabus

plaintiffs have actually underpaid their taxes for 1965, they are not entitled to the refunds claimed. The petition is dismissed.

Taxes; claim for refund; extent of recovery.

[1] In a refund action, a taxpayer cannot recover unless he has overpaid his entire tax liability. Thus, although the Service erred in its allocation of the estate settlement proceeds between capital gains and ordinary income, where there was no overpayment of income tax, taxpayers are not entitled to a refund.

Internal Revenue ⚖1967

Taxes; compromise; compromise settlement of interest in estate; Federal v. State law.

[2] While state law determines who are the heirs of an estate, the validity of the will, and the proper procedure for probate and compromise, once a taxpayer is so determined to be an heir and has so received payment under a valid compromise, the taxability of the compromise proceeds is a Federal question in order to give uniformity to the application of the Internal Revenue Code.

Internal Revenue ⚖19

Taxes; income tax; taxable income; proceeds of compromise of estate litigation.

[3] In determining the tax characteristics attributable to the proceeds of a settlement of litigation respecting taxpayers' interests as overlooked heirs of their grandmother's estate, the crucial question to be resolved is: in lieu of what did taxpayers receive the proceeds? The fact that the settlement was made in cash, rather than in-kind, does not prevent application to some extent of the doctrine of *Lyeth* v. *Hoey*, 305 U.S. 188 (1938), in determining what causes of action were compromised by the settlement agreement.

Internal Revenue ⚖310

Taxes: income tax; taxable income; amounts received in litigation settlement.

[4] Classification for income tax purposes of amounts received in settlement of litigation is to be determined by the nature and basis of the action settled. Amounts received in lieu of lost profits or an award for punitive damages are taxable to the recipient as ordinary income; those received in lieu of corpus of an estate are exempt from income tax.

Internal Revenue ⚖310

Taxes; income tax; taxable income; allocation of proceeds received in litigation settlement.

[5] In determining a reasonable allocation of settlement proceeds among several causes of action, where the agreement itself does not do so, resort to the pleadings is proper and may be helpful.

Internal Revenue ⚖310

Taxes; income tax; taxable income; allocation of proceeds received in litigation settlement.

[6] Where plaintiffs entered into a compromise agreement respecting their fractional land interests as excluded heirs of their grandmother's

estate, a reasonable allocation of the proceeds among their several causes of action is to subtract the adjusted land values (1944 values projected to 1965) from the total proceeds and treat the remainder as compensation for allegedly lost income. Where a taxpayer has received more in settlement than he would have received under a will or through intestacy, he must prove that the excess was something other than income from the property which is the subject of the inheritance claim.

Internal Revenue ⚖310

Taxes; income tax; deductions; expenses for production of income; attorney's fees.

[7] Where it has been determined that a portion of the proceeds of the estate litigation settlement was for lost income from an alleged partnership interest taxable as ordinary income, a pro rata amount of attorney's fees attributable to recovery of such income is deductible under Sec. 212 of the Code.

Internal Revenue ⚖543

Taxes; income tax; adjustments to basis; attorney's fees.

[8] Where plaintiffs entered into a compromise agreement respecting their fractional land interests, attorney's fees incurred in the acquisition of money attributable to the real estate ownership interests, including attendant appreciation thereof, are allowable as an adjustment to basis under Sec. 1016 of the Code.

Internal Revenue ⚖543

Taxes; claim for refund; limitations on allowance of credits and refunds.

[9] An overpayment must appear before refund is authorized. Although the statute of limitations may have barred the assessment and collection of any additional sum, it does not obliterate the right of the United States to retain payments already received when they do not exceed the amount which might have been properly assessed and demanded. *Lewis* v. *Reynolds*, 284 U.S. 281, 283 (1932).

Internal Revenue ⚖1967

Charles E. Parker, pro se, for plaintiffs.

David C. Hickman, with whom was *Assistant Attorney General M. Carr Ferguson,* for defendant. *Theodore D. Peyser,* of counsel.

Before COWEN, *Senior Judge,* NICHOLS and BENNETT, *Judges.*

PER CURIAM: This case comes before the court on plaintiffs' exceptions to the recommended decision of Trial Judge Lloyd Fletcher, filed December 30, 1976, pursuant to Rule 134(h), having been submitted on the briefs and oral

argument of counsel. Upon consideration thereof, since the court agrees with the trial judge's recommended decision, as hereinafter set forth*, it hereby affirms and adopts the same as the basis for its judgment in this case. It is, therefore, concluded that plaintiffs are not entitled to recover and their petition is dismissed.

OPINION OF TRIAL JUDGE

FLETCHER, *Trial Judge:* The taxpayers in this suit for refund of Federal income taxes are Robert I. Meyer and Marilyn E. Parker, brother and sister, and they seek a refund of such taxes and interest thereon which they paid for the calendar year 1965.[1] In 1965, Marilyn and Robert had each received $175,000 in cash as a settlement of a California Superior Court lawsuit. That suit, brought by them against various members of their family (the Segerstroms), asserted that Robert and Marilyn had been improperly excluded from sharing in the estate of their grandmother, Bertha Segerstrom. They demanded a judgment declaring them owners of certain property interests allegedly held by their grandmother, as well as an award of certain compensatory and punitive damages for lost enjoyment and fraudulent concealment. The Internal Revenue Service determined that the settlement transaction resulted in the sale or exchange of a capital asset, namely, the taxpayers' "claim" against Bertha's estate, that a substantial amount of capital gain, attributable to the appreciation of the claim over the some twenty years it remained unasserted was thereby realized, and that this gain amounted to 75 percent of the settlement proceeds.

The taxpayers disagreed entirely with the Service's analysis of the tax consequences of the settlement. After paying tax deficiencies of $16,772.23 plus interest of $3,585.60 and $17,445.57 plus interest of $3,729.53, respectively, Marilyn and Robert filed timely claims for refund,

* Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed December 30, 1976, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

[1] The spouses of these taxpayers are also plaintiffs in this action, but apparently so only because joint income tax returns were filed by each couple for the year in question.

which the Service formally disallowed. They then timely filed their petition in this court for a refund of the amounts so paid. They say that under the doctrine of *Lyeth* v. *Hoey*, 305 U.S. 188 (1938), they are clearly entitled to exclude from taxable income the entire settlement proceeds as being a taxfree "inheritance" within the meaning of Section 102(a) of the Internal Revenue Code of 1954, reading:

> (a) General rule. —Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance. 26 U.S.C. § 102(a).

The Government continues to take essentially the same position as the Service conferee had done in his analysis of the settlement transaction and has treated the receipt of the settlement proceeds as gain realized on the sale or exchange of a capital asset. While the Government's argument has considerable merit and an appealing simplicity, it seems to me subject to some criticism in that it tends to gloss over the Supreme Court's general approach to § 102(a) in *Lyeth* v. *Hoey, supra*, particularly as elaborated in later decisions by the lower Federal courts. As will be shown, one result of this has been a faulty allocation of the settlement proceeds. However, to the extent there was error, it was committed in favor of the taxpayers, and they have failed completely to show any overpayment of their 1965 Federal income taxes. Accordingly, under the landmark decision of *Lewis* v. *Reynolds*, 284 U.S. 281 (1932), they are not entitled to recover the refunds claimed for that year. See, also, *Dysart* v. *United States*, 169 Ct. Cl. 276, 340 F.2d 624 (1965).

The facts of the case are somewhat complicated by the large size of the Segerstrom family of which taxpayers are a part.[2]

C. J. Segerstrom was a farmer engaged mostly in the cultivation of lima beans. He and his wife, Bertha, had

[2] Counsel for the parties were successful in agreeing upon a partial stipulation of facts. In addition, a trial was conducted before Trial Judge Charlotte Murphy in Los Angeles, California, on March 24 and 25, 1975. The findings based upon these proceedings are detailed in the Findings of Fact which are summarized here only to the extent necessary to understand the reasons for the conclusions reached in this opinion.

eleven children, one of whom (Esther) was the mother of plaintiffs, Robert Meyer and Marilyn Parker. Some years prior to his death in 1928, C. J. had formed a partnership with four of his sons as equal partners. They continued the operation of the farming business under the partnership name of C. J. Segerstrom & Sons, and over the years the enterprise expanded considerably. By 1944, it was farming about 2,000 acres, all of which was then agricultural land in Orange County, California. Owing, however, to an influx of defense related industries and accompanying population growth, the character and value of the partnership property experienced a rather spectacular change. Much of the acreage was being serviced by new freeways, and industrial parks and shopping malls began to develop. By the time of the commencement of the litigation referred to above the value of the Segerstrom properties was estimated to be somewhere close to $60,000,000.

Bertha Segerstrom died in January 1944 survived by eight of her children and by Robert and Marilyn, children of her deceased daughter, Esther. Bertha apparently died intestate,[3] and the record discloses no formal administration of her estate although much later there was an inheritance tax proceeding conducted in the Orange County Superior Court. Partnership income tax returns for the family partnership of C. J. Segerstrom & Sons were filed for years following C. J.'s death in which returns Bertha was shown as holding a one-fifth interest therein. However, Bertha's partnership status does not appear to have been otherwise recognized by her sons except possibly for tax purposes, and it is unclear on this record whether she was, in fact, a member of the family partnership. More clear is the fact that there was never a formal dissolution or winding up of the partnership affairs at her death.

Indeed, as previously stated, in the usual sense, there was no formal administration of Bertha's estate at all.[4] However, in 1951, there was a Superior Court proceeding for the determination of state inheritance taxes on certain

[3] In 1951 an inheritance tax appraiser referred to her as having died "testate," but the record here indicates this to have been in error.

[4] It does appear that more than 20 years after Bertha's death, her son, Harold, did file a petition for letters of administration on her estate.

real property received by Bertha's surviving children shortly after her death. According to the state tax assessor's report in that proceeding, this property was transferred pursuant to a "gift deed" executed in 1930 but recorded in 1944 after Bertha's death. By this deed, the surviving eight of Bertha's eleven children appear to have received a joint tenancy with right of survivorship in a property known as the "Home Ranch," a 110-acre farm operated by the family partnership and owned by Bertha. Marilyn and Robert were not mentioned in such deed and were not involved in the 1951 inheritance tax proceeding in any way, nor were they shown as entitled to any share of Bertha's putative partnership interest or any other asset of Bertha. In fact, although it was reasonably clear that they were two of Bertha's numerous heirs-at-law, no effort was made to inform them of the inheritance tax proceeding or of any other matter involving Bertha's estate.[5]

In the 1951 inheritance tax proceeding referred to above, six of Bertha's children filed their petition in the Orange County Superior Court representing that no administration had been had upon Bertha's estate but that in 1930 she had executed a certain deed of gift conveying certain real estate (the Home Ranch) to her then living children as joint tenants with right of survivorship. The petition further represented that the grantees named in the deed comprised all of Bertha's heirs-at-law and that one of them, Ida Segerstrom, had predeceased Bertha. No other property interest of Bertha was mentioned but the petitioners believed that the transfer of the Home Ranch was subject to California inheritance tax which they desired to be determined.

Whereupon the court appointed an inheritance tax appraiser and directed him to report the amount of tax due, if any, on such transfer. In due course, the appraiser reported to the court that the fair market value of the property at the date of Bertha's death was $122,000. After

[5] From the record herein, it is not clear why older members of the Segerstrom family tended to ignore the interests of these two grandchildren of Bertha. It may well be that, as laymen, they simply failed to appreciate the heirship status of both Robert and Marilyn who were very young children when their mother died and who thereafter lived and grew up with families other than the Segerstroms.

deducting therefrom the funeral expenses, unpaid taxes, attorneys' fees, court costs, unpaid balances of trust deeds, and Federal tax, he arrived at a "clear market value" for the property of $78,183. Bertha's eight surviving sons and daughters thereupon paid their aliquot share of the resulting inheritance tax totaling $763.68.

As stated, Marilyn and Robert, Bertha's other heirs, were completely unaware of the inheritance tax proceeding. However, in 1963, Marilyn's husband, Charles E. Parker, who was a title attorney for the First American Title Company, happened to examine the probate file for the estate of Ida Segerstrom, a daughter of Bertha who predeceased her. Reference was made in this file to Bertha's estate and to the 1930 deed of gift in which Ida was an original donee. Charles was intrigued by what appeared to him to be inconsistencies in these records. He and Marilyn then consulted her brother, Robert. While he knew nothing about the matter, he was, of course, interested.

Charles continued his investigation and consulted with his colleagues at the title company. Marilyn and he also made inquiries of members of the Segerstrom family.

The result of all this was the commencement of litigation. In July 1964, Harold T. Segerstrom, et al. filed a Complaint to Quiet Title, naming Robert, Marilyn, and unknowns as defendants.

Marilyn and Robert counterclaimed in the quiet title suit and joined many other relatives as parties defendant to the cross-complaint. This cross-complaint, as later amended, alleged not only that Marilyn and Robert were entitled to a share of the Home Ranch, but also that they were entitled to a share of Bertha's partnership interest, that they were entitled to lost income since 1944, and that the cross-defendants had defrauded them and engaged in a continuing conspiracy of concealment to deprive them of their rightful interest. The taxpayers demanded $10 million dollars in punitive damages for the torts. They also demanded a declaration of ownership in the property withheld from them, *i.e.*, the lands and the partnership interest, plus $5 million dollars for lost income.

Opinion of Trial Judge

The entire suit, including the cross-complaint, proceeded to the pretrial stage, and extensive depositions were taken in preparation for trial. However, the suit was settled. The settlement was accomplished partly because one of the older Segerstroms who had been scheduled for deposition was in frail health, partly because a *lis pendens* which taxpayers had filed against all partnership property, even though previously removed, was nevertheless hampering significant business negotiations, partly because there had been uncovered another gift deed to the Home Ranch (this one executed and predating the 1930 gift deed but not filed until 1965), and partly because the suit was splitting the family apart as well as affecting its intricate development negotiations. Marilyn and Robert each received $175,000 as their one-half share of the total settlement, and it is the taxability of this receipt which is presently in issue here.

In a perceptive analysis written before the Supreme Court's decision in *Lyeth* v. *Hoey, supra,* a distinguished tax commentator aptly described the nature of receipts flowing from a compromise agreement entered into to avoid a will, or other post-mortem, contest as "irritatingly elusive of definition." Paul, "Tax Status of Will Contestants," Selected Studies in Federal Taxation (2d Series) pp. 305, 328 (1938). The Supreme Court endeavored to correct the existing confusion by its decision in the *Lyeth* case.

There the taxpayer, Lyeth, was a grandson and heir under Massachusetts law of Mary Longyear, who left him and her other heirs small legacies but gave the residue of her estate of over $3,000,000 in trust to preserve "the records of the earthly life of Mary Baker Eddy," the founder of the Christian Science religion. Lyeth and the other heirs opposed probate of the will on grounds of lack of capacity and undue influence. Before the case came to trial, a compromise agreement was entered into by all parties, approved by the Court and incorporated in its decree admitting the will to probate as modified by the agreement. Lyeth's distributable share of the residue under the compromise was valued at over $140,000, all of which the Commissioner treated as ordinary income in the year of receipt. The case came up on action for refund of over $56,000 in taxes paid on this award, the Second Circuit

siding with the Commissioner in 96 F. 2d 141, and the Supreme Court granting certiorari on the resulting conflict with the Fourth Circuit in *Magruder* v. *Segebade*, 94 F. 2d 177, (4th Cir. 1938).

The Court first discarded the argument that under state law the payment would be deemed to have been made by purchase (i.e., a contract bargain) rather than by inheritance. The Court recognized that state law determines who are the heirs, the validity of the will, and the procedure for probate and compromise. But once the taxpayer is so determined to be an heir and has so received payment under valid compromise, whether what he has received has been "acquired by gift, bequest, devise or inheritance" under the Code section quoted above is then properly a federal question in order to give uniformity to the application of the Code.[6]

The Court then ruled that, in passing the Code exemption above, Congress used comprehensive terms embracing all acquisitions in the devolution of a decedent's estate. This was such an acquisition because of Lyeth's status as an heir-at-law. The Court elaborated the point at p. 196:

> There is no question that petitioner obtained that portion, upon the value of which he is sought to be taxed, because of his standing as an heir and of his claim in that capacity. It does not seem to be questioned that if the contest had been fought to a finish and petitioner had succeeded, the property which he would have received would have been exempt under the federal act. Nor is it questioned that if in any appropriate proceeding, instituted by him as heir, he had recovered judgment for a part of the estate, that part would have been acquired by inheritance within the meaning of the act. We think that the distinction sought to be made between acquisition through such a judgment and acquisition by a compromise agreement in lieu of such a judgment is too formal to be sound, as it disregards the substance of the statutory exemption. It does so, because it disregards the heirship which underlay the compromise, the status which commanded that agreement and was recognized by it.

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[6] This general proposition is, of course, well settled. See, *Burnet* v. *Harmel*, 287 U.S. 103 (1932) and the discussion in Michaelson, "Tax Effects of Estate Contests," 16 N.Y.U. Tax Inst. 1021 (1958).

The rule thus established by *Lyeth* seems but a specialized application of the familiar concept that, in determining the tax characteristics attributable to amounts received under a court judgment, the crucial question to be resolved is "In lieu of what were the damages awarded?" *Raytheon Production Corp.* v. *Commissioner*, 144 F. 2d 110, 113 (1st Cir. 1944), *cert. den.* 323 U.S. 779 (1944). *Lyeth* established that the question is equally important in determining the true nature of proceeds received in settlement of estate litigation.

Thus, it is clear that the ultimate question to be resolved in the present case must be this. In lieu of what did Marilyn and Robert receive $350,000 in settlement of their cross-complaint against the other members of the Segerstrom family. From the discussion below, it will become apparent that the answer to this deceptively simple question is far from easy.

The Government's approach to the "in-lieu-of-what" test is objectionably narrow. It would restrict the *Lyeth* v. *Hoey* doctrine to a situation where the settlement proceeds constitute a portion of the same assets which the caveator-heir would have received either by direct inheritance or by prevailing in his lawsuit to recover such inheritance. It is true that on its particular facts, *Lyeth* did involve a settlement under which the proceeds received by the heir were for the most part an in-kind distribution. However, this circumstance does not prevent application of the *Lyeth* principle to a cash settlement in lieu of an in-kind distribution. See, for example, *United States* v. *Gavin*, 159 F. 2d 613 (9th Cir. 1947) where in the settlement of a will contest, the claiming heiress received a substantial sum of money from the other heirs in lieu of her claimed percentage interest in the decedent's real estate. The Government made much the same arguments there as here, but the Tenth Circuit Court of Appeals rejected them as contrary to *Lyeth* v. *Hoey* and held that the cash settlement proceeds were property acquired by "inheritance" so as to be exempt from income tax.[7] See, also,

[7] The Government's failure to mention the very apposite *Gavin* case in its brief here probably is indicative of a complete disagreement with the case.

Schenck, "Tax Effects of Will Contests and Compromises," 1961 Tul. Tax Inst. (10th Annual) 214, and Fouts, "Payments Received in Settlement of Litigation and Claims," 25 N.Y.U. Tax Inst. 555 (1967).

The Government, however, relies heavily on *White* v. *Thomas*, 116 F. 2d 147 (5th Cir. 1941) in support of its position that the *Lyeth* principle has no application here. In the *White* case, the taxpayer had filed suit against an estate claiming that, during their lifetimes, the decedent and her husband had given him a 124,000-acre ranch. He bore no family relationship whatever to the decedents but was their good friend and house companion. The dispute was settled by a compromise agreement whereby the executors paid the taxpayer $125,000 in exchange for his release of all claims against the estate. He asserted that the entire amount was exempt from income tax under *Lyeth*, but the Fifth Circuit disagreed, stating:

> . . . When what is received by a compromise is a part of the very thing claimed, the assertion is correct. If White, claiming all the ranch as a gift, had been conceded part of it, the land he thus got would stand as a gift. But in this case he got no land, but money. Yet he never claimed the Shannons had given him any money. The executors and trustees had no authority to give him anything, and did not intend to. They paid him money for the release of the right which he claimed in the land. White sold that right, and conveyed it by suffering the adverse judgments. He converted it into cash; and the gain from the conversion of a gift is taxable, though the receipt of the gift originally was not. He did not sell the land itself, for he had neither title nor possession. He could not deduct the cost of the land to the Shannons, for they never parted with it and no proof of their cost was made. He sold only his claim to recover it, which was in the nature of an incumbrance on the title, at a price which was only a fraction of the value of the land; and that claim he does not say cost him anything. What he received is income. 116 F. 2d 147–8.

Despite the rather sweeping language just quoted, the *White* case is simply not in point here because of its significantly different facts. Unlike the present case, the taxpayer there was not an heir in any way so there could be no possible claim of entitlement to anything by way of

"inheritance." Clearly, there was no "devise" of the land to him, and his claim that he was the donee of an oral *inter vivos* "gift" thereof equally clearly could not convey a valid title to real estate and was therefore ineffectual at best. Small wonder, then, that the court could "perceive no sustainable view whereby the money received would not be taxable as income." 116 F.2d 148.

From what has been said, it is concluded that the principles established by *Lyeth* v. *Hoey* have at least some application to the facts of the present case. This is not the end of the matter, of course, since it does not follow that *Lyeth* automatically exempts from tax the entire amount received by plaintiffs under the compromise agreement. There remains for consideration the impact, if any, of the "in-lieu-of-what" rule referred to above, and this necessarily requires an analysis of what claims were compromised by the settlement agreement.

Under his contention that the entire transaction should be viewed as a sale by Marilyn and Robert of their claim against Bertha's estate, it was necessary for the I.R.S. conferee to construct a 1944 basis for the claim from which gain or loss could be computed. This proved to be extraordinarily difficult not only because of the lapse of time and the failure to administer Bertha's estate,[8] but also because of the large number of real estate parcels involved coupled with the fact that a number of changes in the Orange County Tax Assessor's records over the years had rendered it virtually impossible to trace all Segerstrom parcels back to 1944.

During the course of negotiations, it was finally determined, with the assistance of a private tax research firm selected by taxpayers' then counsel, with the conferee's approval, that five parcels of land should be traced from 1944 to 1965. After comparing the value of these parcels of

[8] A simple approach, of course, would have been to accept the determination of the California inheritance tax appraiser that Bertha's entire estate was comprised only of the Home Ranch and was worth only $122,000. Computing taxpayers' basis as one-ninth of that amount would result in a total basis of only $13,555. Despite its simplicity, such an approach would have been manifestly unfair, for it ignores the myriad other serious claims made by Marilyn and Robert in their cross-complaint. Indeed, the I.R.S. conferee seems to have recognized the unfairness of any such approach.

land and after additional negotiations, the conferee decided that, with respect to real estate in the vicinity of land allegedly owned wholly or partially by Bertha Segerstrom, approximately 25 percent of the land's 1965 value represented its value in 1944 and 75 percent represented appreciation in value between 1944 and 1965. Applying these percentages to the amounts received by Marilyn and Robert in settlement of the litigation, the Service finally determined that taxpayers' claim had a total value in 1944 of $90,404. Adding to this basis the $80,000 in attorney's fees incurred by taxpayers, a total basis of $170,404 was established, leaving the balance of $179,596 as a taxable long-term capital gain.

From the foregoing it is obvious that the Government views the settlement proceeds of $350,000 received by Marilyn and Robert as totally allocable to that portion of their cross-complaint which demanded a declaration of part ownership in the various Segerstrom real properties. In my opinion, however, such an allocation is erroneous since it ignores the other causes of action alleged in the cross-complaint which undoubtedly played a significant role in bringing about the eventual settlement.

It is clear that the Service conferee erred in failing to consider all causes of action alleged by Marilyn and Robert in their cross-complaint to which some portion of the settlement proceeds could have been allocated. The rule has been well stated by the Eighth Circuit Court of Appeals in *Carter's Estate* v. *Commissioner*, 298 F. 2d 192 (8th Cir. 1962) where the court said at p. 194:

> It is well-settled law that the classification for tax purposes of amounts received in settlement of litigation is to be determined by the nature and basis of action settled. [Citing cases.] If it is found that such a settlement is one in respect to a claim for lost profits or partly for lost profits and partly in lieu of punitive damages such as are recoverable in anti-trust litigation, there can be no question as to their taxability as ordinary income. [Citing cases.]

See, also, Rev. Rul. 58–418, 1958–2 C.B. 18 holding that amounts received in lieu of an award for punitive damages are taxable to the recipient as ordinary income. On the

other hand, of course, under *Lyeth* and *Gavin, supra,* amounts received in lieu of corpus of an estate will be exempt from income tax. *Cf. Harte* v. *United States,* 252 F.2d 259 (2d Cir. 1958).

Because of uncertainties as to the assets comprising Bertha's estate, if any, because the state court never entered a judgment in the present case, and because the settlement agreement itself made no specific allocation of the proceeds, the court unfortunately is deprived of the usual guidelines for determining a reasonable allocation. *Cf. Tree* v. *United States,* 102 Ct. Cl. 128 (1944), *cert. den.* 324 U.S. 852 (1945) where this court closely examined the terms of a more precise settlement agreement in applying the "in-lieu-of-what" test.

In the Fourth Cause of Action set forth in their cross-complaint, as amended, Marilyn and Robert alleged fraud and concealment on the part of their uncles, who were the surviving partners in the family partnership, and accordingly, they prayed for "punitive damages" in the sum of $10,000,000. However, in the ensuing settlement agreement, Marilyn and Robert agreed that all such allegations of fraud, misrepresentation and concealment were untrue and without merit. In view of this concession, it would seem highly unrealistic to allocate any portion of the settlement proceeds to the tort demands for punitive damages, and they are, therefore, eliminated from consideration.

Elimination of those issues leaves for analysis the other causes of action asserted in the cross-complaint. Essentially they are reducible to demands for (1) a one-fifth ownership interest in the Home Ranch, (2) a one-forty-fifth ownership interest[9] in any real estate held by the family partnership, and (3) compensatory damages for loss of what the cross-complaint calls "the use, enjoyment, rents, issues, and profits" attributable to the complainant's interest in Bertha's estate and alleged to aggregate $5,000,000. Demand was made for an accounting of all of the partnership property and the profits therefrom since Bertha's death.

[9] The fraction of 1/45 was calculated as one-ninth of Bertha's one-fifth interest in the partnership.

In determining a reasonable allocation of the settlement proceeds among these several causes of action, where the agreement itself does not do so, resort to the pleadings is proper and may be helpful. See, for example, *Raytheon Production Corp.* v. *Commissioner, supra; State Fish Corp.*, 48 T.C. 465, clarified at 49 T.C. 13 (1967); *Telefilm, Inc.*, 21 T.C. 688 (1954), reversed on another point 55–1 USTC ¶ 9453 (9th Cir. 1955); and Rev. Rul. 58–418, *supra. Cf. Tree* v. *United States, supra.* In the present case, the pleadings placed a monetary value only on the cause of action for lost profits, while the remaining demands sought only a declaration of part ownership in realty. However, at the trial of this tax dispute, evidence was produced which for allocation purposes sufficiently fixes the value of the Home Ranch and the partnership realty as of 1944, the year of Bertha's death.

For California inheritance tax purposes, the Home Ranch was estimated to be worth $122,000. The 2,000 acres of partnership realty were estimated to be worth no more than $1,000 per acre, or $2,000,000 for the entire 2,000 acres. Thus, if Marilyn and Robert had inherited their alleged shares of Bertha's estate in 1944, by intestate succession, they would have collectively received a one-ninth interest in the Home Ranch plus a 1/45 interest in the partnership, and at 1944 valuations, this would amount to a $13,555 interest in the Home Ranch and a $44,444 interest in the partnership realty. The $5,000,000 demanded for lost income from the partnership operations between 1944 and 1965 represents a 1965 evaluation, however, and cannot be simply added to the 1944 values without gravely distorting the base figure for allocation. The 1944 values should be adjusted and projected to 1965 by using the realty appreciation factor developed during the several conferences with I.R.S. conferees. This factor showed a mean growth of about 500 percent for all Segerstrom properties.

Thus, in terms of 1965 values, the taxpayers sought in the cross-complaint a $67,775 (500 percent of $13,555) interest in the Home Ranch, a $222,220 (500 percent of $44,444) interest in the partnership realty, and a $5,000,000 judgment for lost income. Hence, approximately

$290,000 in real property interests and $5,000,000 in lost income were sought.

There are two choices for allocating at this point. First, the $350,000 settlement can be prorated according to the ratios that the real property interests and the income interest bear to the total amounts demanded; i.e., 290,000/5,290,000 (or 5.5 percent) of the settlement for land interests and 5,000,000/5,290,000 (or 94.5 percent) for the lost income. This method allocates almost all of the settlement to income and is unrealistic because it mixes plaintiffs' likely inflated and fictional demands for allegedly lost income with the actual real property values. The second and, under the circumstances here, more reasonable choice is to subtract the adjusted land values from the total settlement proceeds and treat the remainder as compensation for allegedly lost income. By this calculation, $290,000 of the settlement proceeds would have been received in lieu of the ownership interests asserted in the real property, and the remainder of $60,000 would be attributable to the claimed compensatory damages for lost income.

Under such an allocation, taxpayers obviously would be liable for tax at ordinary income rates on the full $60,000, since that portion of the settlement was received in lieu of ordinary income and is therefore not excluded from income by Section 102, even as extended by *Lyeth*. See, *Harte* v. *United States*, *supra*, and *Raytheon Production Corp.* v. *Commissioner*, *supra*.

As to the proceeds received in lieu of the fractional ownership claims to realty, Section 102, as interpreted in *Lyeth*, allows that portion received by reason of heirship and thus akin to "inheritance" to be excluded from taxable income. Since the values of plaintiffs' 1944 inheritance, as computed above, were $13,555 for the Home Ranch and $44,444 for the partnership interest in realty, these amounts are excludible from gross income under Section 102.

However, the remaining $232,000 received in lieu of the claims to fractional ownership of real estate has not been shown by the taxpayers to be anything other than taxable income, after an adjustment, discussed below, for attorney's fees. It was, of course, open to them to show that this

remainder was some sort of capital item such as unrecovered basis, or somehow otherwise not subject to income tax. They were unable to do so, however. All the evidence submitted can lead to no other conclusion but that this remaining amount was received in lieu of the rather spectacular appreciation of the properties over the 21-year period between the date of death and the date of settlement.[10]

The Government says that this realized appreciation was taxable as long-term capital gain. While for reasons previously stated, the Government's allocation procedure was faulty, I agree with its basic contention that the settlement here constituted a taxable event to be measured, *inter alia,* by the appreciation over the years. Accordingly, taxpayers are liable for long-term capital gains tax on $168,560, as computed in the schedule below.

Finally, there remains for consideration the I.R.S. allowance of taxpayers' attorney fees as an adjustment to the basis of their "claim". Section 1016(a) of the Code allows as an adjustment "expenditures . . . properly chargeable to capital account . ." Here the attorney's fees, insofar as they were expended in the acquisition of property, are available for adjustments to basis. See, *Woodward* v. *Commissioner,* 397 U.S. 572 (1970), and *Elrick* v. *Commissioner,* 485 F.2d 1049 (App. D.C., 1973). Also, Section 212 allows as a deduction "all ordinary and necessary expenses paid or incurred . . . for the production or collection of income."

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[10] In tacit recognition of the fact that income was generated by this entire transaction, taxpayers suggest that, if so, such income was not taxable to them but either to Bertha's estate or to the cross-defendants. The theory seems to be that whatever the amount taxpayers received by the settlement, it was only their "inheritance" and therefore subject to the Section 102 exclusion from gross income without reference to the source of the proceeds. The difficulty with this argument is that in other cases where the taxpayer, as here, has received more in settlement than he would have received under a will or through intestacy, he must prove that the excess was something other than income from the property which is the subject of the inheritance claim. See, for example, *E. C. Delmar,* 25 T.C. 1015 (1956). The argument also fails to take into account that if such excess is income upon which income tax should have been paid, the recipient heir may well be liable for such tax under the transferee provisions of Section 6901 of the Code. In the circumstances of this case, however, it is unnecessary to reach that question, particularly since the Segerstroms agreed in the settlement agreement to hold harmless Marilyn and Robert for any possible transferee liability.

Here Marilyn and Robert expended $80,000 in attorney's fees to secure the settlement proceeds. As shown above, of the settlement proceeds, $60,000 was for lost income from the alleged partnership interest. A pro rata amount of the attorney's fees attributable to recovery of such income, or approximately $16,560, is therefore deductible under Section 212. Treas. Reg. § 1.212–1(k) (1965). The remainder of the attorney's fees, $63,440, is allowable as an adjustment to basis under Section 1016, since it was expended in the acquisition of money attributable to the real estate ownership interests (which, as previously discussed, included the attendant appreciation). *Cf.* Rev. Rul. 58–418, *supra* (amount of settlement not includible in income reduces proportionately the amount of attorney's fees deductible under Section 212).

In summary, the taxpayers have been required by the Service to include in gross income $179,596[11] on which they paid income taxes at long-term capital gain rates. However, the record here shows that as a result of the settlement the taxpayers should have reported net income of $212,000 of which $43,440 (in lieu of lost income) was taxable as ordinary income and $168,560 was taxable as long-term capital gain.[12]

[11] $350,000 settlement proceeds less $170,404 comprised of $90,404 basis and $80,000 attorney's fees.

[12] To arrive at the amount reportable by each taxpayer, of course, these figures would simply be divided by two.

The following schedule shows the results of the foregoing allocation in tabular form:

Total Amount Received Under Settlement		$350,000
Less Adjusted Basis:		
Amount received as "inheritance"	$58,000	
Portion of attorney's fees attributed to basis	63,440	
Less amount attributed to lost income and taxable as ordinary income	60,000	181,440
Amount taxable as long-term capital gain		$168,560
Amount Taxable as Ordinary Income	60,000	
Less portion of attorney's fees attributed to lost income	16,560	43,440
Total of taxable settlement proceeds after above adjustments		$212,000

From this table it is at once apparent that far from showing an overpayment of their 1965 income taxes, the taxpayers have actually underpaid their taxes for that year.[13] Nearly 45 years ago, the United States Supreme Court in its decision in *Lewis* v. *Reynolds*, 284 U.S. 281, 283 (1932) instructed us that in tax refund cases:

> . . . An overpayment must appear before refund is authorized. Although the statute of limitations may have barred the assessment and collection of any additional sum, it does not obliterate the right of the United States to retain payments already received when they do not exceed the amount which might have been properly assessed and demanded.

Accordingly, plaintiffs are not entitled to the refunds claimed, and their petition must be dismissed.

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[13] Apparently satisfied with the amount of taxes previously collected, however, the Government has not counterclaimed for any additional tax.

Syllabus

CONCLUSION OF LAW

Upon the trial judge's findings and the foregoing opinion, which are adopted by the court, the court concludes as a matter of law that plaintiffs are not entitled to recover, and their petition is dismissed.

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571 F.2d 25

B-E-C-K CONSTRUCTORS, A JOINT VENTURE, CONSISTING OF CUMMINS-EGGE, INC., AND KOONBOEN, INC.; FRANK WHITE, D/B/A W & S CONSTRUCTION COMPANY v. THE UNITED STATES

[No. 391–72. Decided February 22, 1978]

ON THE PROOFS

Contracts; breach; Government obligation; delay in removal of equipment.—Plaintiff, an experienced Alaskan contractor, was awarded a contract for the rehabilitation of Baker air field runway in Amchitka, Alaska, preparatory to use by personnel in connection with a series of underground nuclear tests. The contract obligated defendant to transport plaintiff's equipment from Seattle to Amchitka and to return the equipment to Seattle on a space available basis after 30 days' notice. The equipment used for the runway came from Seattle, Seward and Adak. While the contract did not provide for diversions to other ports between Seattle and Amchitka, nor fix responsibility for costs of diversions, plaintiff arranged through correspondence with the Corps of Engineers (COE) for off-course diversion into Seward to pick up some of its equipment. Arrangements for demobilization of equipment, however, were verbal and of an informal nature. Claiming breach of contract, plaintiff seeks damages for the Government's delay of nearly 4 months in providing return barge transportation after notification in August 1969 that the equipment was ready for removal. It is *held* that absent any effort by plaintiff to clarify the contract by formal amendment, or at least by correspondence with the COE, or to take other actions adequate to remove the confusion, plaintiff may not be relieved of its responsibility for the ambiguous situation regarding available barges, particularly in view of the complicated character of the nuclear testing, with multiple Government agencies involved, plaintiff's experience in barge transportation and scheduling, the Adak and Seward diversions desired by plaintiff which departed from literal provisions of the contract, plaintiff's imprecise method of operations, lack of formal

written arrangements covering payment for diversions, and the low priority character of plaintiff's equipment as regards sequence of removal. Plaintiff is not entitled to recover; defendant is entitled to recover $1,849.50 on its counterclaim for a diversion into Adak to return certain of plaintiff's equipment. The petition is dismissed.

Contracts; interpretation; uncertainty as to time.

[1] Where a time is not fixed in a contract for performance of an obligation, performance within a reasonable time, dependent upon the circumstances applicable, is required. Where no time limit is given, it is presumed that performance will be concluded within a reasonable time.

Contracts ⟸212(2)

Lyle L. Iversen, attorney of record, for plaintiff. *Lycette, Diamond & Sylvester,* of counsel.

Ray Goddard, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before COWEN, *Senior Judge,* NICHOLS and BENNETT, *Judges.*

PER CURIAM: This case comes before the court on plaintiff's exceptions to the recommended decision of Trial Judge Kenneth R. Harkins, filed July 7, 1977, pursuant to Rule 134(h), having been submitted on the briefs and oral argument of counsel. Upon consideration thereof, since the court agrees with the trial judge's recommended decision, as hereinafter set forth*, it hereby affirms and adopts the said decision as the basis for its judgment in this case. It is, therefore, concluded that plaintiff is not entitled to recover on its petition and that defendant is entitled to recover $1,849.50 on its counterclaim. Accordingly, judgment is entered for defendant on its counterclaim against plaintiff in the sum of $1,849.50 and plaintiff's petition is dismissed.

OPINION OF TRIAL JUDGE

HARKINS, *Trial Judge:* In connection with the Atomic Energy Commission (AEC) program for underground nuclear tests on Amchitka Island, Alaska, B-E-C-K Constructors

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* Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed July 7, 1977, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

was awarded a prime contract by the Alaska District of the Army Corps of Engineers for work to resurface and seal an airport runway (Baker runway) on the island.[1] The work, originally priced at $782,405, and subsequently increased to approximately $900,000, required about 3 months, and was substantially finished, to the complete satisfaction of defendant, on August 10, 1969.

The contract[2] provided for defendant to "furnish barge transportation for equipment and material between Seattle, Washington and Amchitka, Alaska." Defendant, however, did not provide barge transportation to remove some of plaintiff's equipment until December 16, 1969, nearly 4 months after plaintiff had notified the Corps of Engineers (COE) that the equipment was ready to be removed. Plaintiff now seeks damages for breach of contract for the delay in return of its and its subcontractor's equipment.[3] For the reasons that follow, defendant satisfied its contractual obligations to return plaintiff's equipment and is not liable for any damage incurred by plaintiff.[4]

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[1] The style of this case designates Frank White, d/b/a W & S Construction Company, as plaintiff. Frank White is an independent contractor to B-E-C-K Constructors under the Amchitka Baker runway contract and is not in contractual privity with defendant. The subcontract did not contain an exculpatory provision that relieved the prime contractor of liability, and B-E-C-K Constructors may maintain this action for damages to its subcontractor. The doctrine of *Severin* v. *United States*, 99 Ct. Cl. 435 (1943), *cert. denied*, 322 U.S. 733 (1944), does not apply. *Blount Bros. Constr. Co.* v. *United States*, 172 Ct. Cl. 1, 348 F.2d 471 (1965); *Seger* v. *United States*, 199 Ct. Cl. 766, 469 F.2d 292 (1972).

[2] DACA85–69–C–0063 (contract 0063), dated April 16, 1969.

[3] Contract 0063 is on Standard Form 23 and contains the standard articles for changes, disputes, and suspension of work, and a special provision in which defendant, through the COE, obligated itself to furnish barge transportation and related loading/unloading costs, between Seattle, Washington, and Amchitka, Alaska. Defendant's delay in removal of plaintiff's equipment from Amchitka may have been amenable to administrative disposition through disputes clause procedures as a constructive suspension of work. The ASBCA declined jurisdiction of plaintiff's claim and both parties have proceeded in this court on breach of contract concepts. The administrative remedy provided by the contract is not jurisdictional and is a procedural right that may be waived by the parties. *Nager Elec. Co.* v. *United States*, 184 Ct. Cl. 390, 401, 396 F.2d 977, 982–83 (1968); *George Bennett Constr. Co.* v. *United States*, 178 Ct. Cl. 61, 71, 371 F.2d 859, 864 (1967). In September 1975, a 4-day trial was conducted in Seattle, Washington, by former Trial Judge Charlotte P. Murphy.

[4] The findings of fact detail the course of conduct that is the basis for plaintiff's claim. The opinion summarizes only the facts necessary to provide a context for the decision.

The Atomic Energy Commission in 1969 and 1971 conducted on Amchitka a series of full-scale underground tests of nuclear warheads for the Spartan missile. Baker runway, built during World War II, required resurfacing and sealing to be usable for movement of personnel and equipment for these tests. The test program was a large project that involved approximately 100 contractors and subcontractors, and the cost of preparation of the island amounted to approximately $285 million.

The contractual structure was complex. The AEC directly administered the principal drilling and mining contracts. The COE was utilized by the AEC in a supporting role for rehabilitation of the runway and for other earthwork. Holmes & Narver, Inc. (H & N) held an architect-engineering management contract from the AEC and was responsible for logistical support and surface construction for the test program. H & N had the responsibility for movement of all personnel and equipment to the island and, for this purpose, subcontracted with the Foss Launch & Tug Company (Foss) for all barge transportation.

The AEC principal office was located in Las Vegas, Nevada. H & N maintained offices in Las Vegas, Seattle, and on Amchitka. Plaintiff was located in Seattle, Washington, and Frank White, as field superintendent on Amchitka, managed the Baker runway contract work. The COE area engineer, who was the contracting officer's representative for contract 0063, was located in Anchorage, Alaska. Plaintiff's problems in the removal of its equipment from Amchitka, to a large extent, were due to difficulty of communications between these various, widely separated, offices.

In addition to the Baker runway project, B-E-C-K Constructors participated in the Amchitka test program in another joint venture known as B-E-C-K C-R-K & Associates, an association composed of Christenson, Raber-Kief & Associates. B-E-C-K C-R-K & Associates, as a joint venture, had a management and operation subcontract from H & N, part of which involved provision of stevedoring services to load Foss barges.

In the Amchitka test project, defendant agreed to supply surface transportation for equipment and material to and from the island. Contract 0063 provided that defendant would furnish barge transportation for equipment and material "between Seattle, Washington and Amchitka, Alaska," and would be responsible "for docking fees, loading and unloading at Amchitka Island, Alaska and Seattle, Washington." Transportation was required to "be scheduled with and approved by the Contracting Officer." Loading for plant and equipment was to "be scheduled 30 days prior to shipment" except that on initial mobilization loading would be "initiated on 10 day notification." On the return trip from Amchitka Island to Seattle, Washington, transportation would "be on a space available basis."

There are no provisions in the contract that specifically would allow for diversions to other ports on trips between Seattle and Amchitka, or which would provide a procedure for such arrangements. Nor were there provisions that would fix the responsibility for the costs of any such diversions. Plaintiff's claim requires contract 0063 to be interpreted as though it included a provision to the effect that diversions to ports en route between Seattle and Amchitka would be permitted on plaintiff's request when plaintiff made its own arrangements for, and paid for, such diversions with the barge operator. No amendment for this purpose was ever requested or made, however, and such interpretation must find its basis in an implication from the facts and the conduct of the various parties that were involved on behalf of the defendant.

Defendant contends that the contract only requires the Government to return plaintiff's equipment to Seattle, Washington, on a "space available" basis after 30 days' notice. Any diversion to other ports was solely for the benefit of plaintiff and would be an accommodation wholly apart from and distinct from the contract provisions.[5] This contention disregards the extensive course of dealings that exist in contract 0063 and generally in COE contracts for Alaskan operations. In the factual circumstances of this

[5] Defendant cites *Vogt Bros. Mfg. Co.* v. *United States*, 160 Ct. Cl. 687, 702 (1963); *Tri-Cor, Inc.* v. *United States*, 198 Ct. Cl. 187, 458 F.2d 112 (1972).

case, however, taking into account the practice to allow off-course diversions, defendant's removal of plaintiff's equipment designated for diversion to Adak and Seward was a reasonable compliance with the contractual arrangements.

The route from Seattle to Amchitka, on a geographical basis, bypasses the ports of Adak and Seward, located along the Aleutian crescent. It is not substantially out of the way for a barge going between Seattle and Amchitka to go off course to call at either Seward or Adak. Plaintiff was an experienced Alaskan contractor and, in previous dealings with the COE, diversions were arranged informally in the normal course of operations for the convenience of the parties. When satisfactory arrangements were made for the contractor to pay any additional costs, the COE had no objection to the contractor dealing directly with the tug company for off-course diversions.

When plaintiff mobilized for the Baker runway project, its equipment came from three locations—Seattle, Seward, and Adak. By correspondence, and at a preconstruction and safety conference on May 7, 1969, plaintiff and the COE made arrangements for an off-course diversion into Seward. As provided in contract 0063, plaintiff's Seattle-based equipment was loaded and departed Seattle, Washington, on Foss barge 210 on May 14, 1969; the barge, pursuant to written arrangements with the COE, was sent off course to pick up plaintiff's equipment at Seward. The equipment that originated at Adak moved to Amchitka on a barge provided by plaintiff at no cost to defendant.

The correspondence related to the off-course diversion into Seward shows that the COE agreed with plaintiff that the procedure was part of normal operations under the contract. It is not clearly established in the record, however, that the correspondence and discussions relative to the inbound transportation to Amchitka were intended to apply also to return arrangements after completion of the project. Contract 0063 itself distinguishes arrangements in mobilization from those in demobilization, and provides special notice requirements in the initial mobilization phase, presumably in the interest of timeliness in the test program.

Plaintiff's April 25, 1969, request for barge transportation sought permission to send the barge off course to load equipment at Seward and provided for arrangements to be made to have dock space available for an inspection of the equipment. The COE's May 5, 1969, reply stated "this office has no objection to the diversion of the government barge to Seward, Alaska provided there are no additional costs to the government." The letter also provided that "[a]rrangements for payment of these costs will be made by you directly with Foss Barge Company in Seattle, Washington."

By August 10, 1969, work on contract 0063 was substantially completed. In the retrograde (demobilization) phase, there is no exchange of correspondence, or record of conferences between the COE and plaintiff, that would supply a contractual basis comparable to the exchange of correspondence that was made in the mobilization phase. The arrangements in demobilization were made through verbal communications and other informal arrangements and there is no direct exchange of correspondence between plaintiff and the COE. Instead, there are numerous written "actions" among defendant's representatives with copies to each other and to plaintiff. These communications cast substantial doubt on such questions as whether plaintiff had requested special treatment for return of Seattle-bound equipment and whether the AEC Amchitka representative expected further communications from plaintiff to H & N relative to arrangements for the requested diversions. These ambiguities could have been avoided, and plaintiff should have taken steps to clarify the special arrangements it sought. In the absence of any effort to clarify the contract by formal amendment, or at least by correspondence with the COE, plaintiff may not be relieved of its responsibility for the ambiguous situation that resulted.

Plaintiff notified the COE contracting officer's representative in Anchorage, by telephone, on August 10, 1969, that the equipment was ready to be removed and requested that it be removed as soon as possible. The contracting officer's representative, on the basis of plaintiff's verbal request,

notified H & N by telephone that plaintiff's equipment was ready to be removed.

Plaintiff's verbal request for a loading date was confirmed in writing by letters to Anchorage, sent from Seattle on August 13 and from Amchitka on August 14, 1969. When these letters were sent, plaintiff believed that the August barge would depart Amchitka on August 18, and plaintiff requested shipment on that barge. The barge, however, departed Amchitka on August 13, before either of plaintiff's letters was delivered to the COE representative at Anchorage.

Both the August 13, 1969, request from plaintiff's project administrator in Seattle and the August 14, 1969, request from plaintiff's field superintendent on Amchitka listed particular pieces of equipment designated for three destinations: (1) equipment to be scheduled off course for Adak; (2) equipment to be scheduled off course for Seward; and (3) equipment to be returned to Seattle. By letter dated August 18, 1969, the COE representative formally requested H & N in Seattle to allocate space on the first available barge to depart Amchitka. This letter noted that plaintiff had requested off-course scheduling for Adak and Seward, and the COE representative requested "your earliest consideration be given for the movement of the Seattle-destined equipment due to future commitments by B-E-C-K Constructors in the Seattle area."

Plaintiff's Amchitka field superintendent's August 14, 1969, letter was transmitted to the AEC site engineer on August 15, who, in turn, forwarded it to H & N's Amchitka representative on August 16 with a memorandum that stated "[a]dditional information, re Contractor vs Government responsibility including insurance to follow." On August 27, 1969, the AEC Amchitka representative requested the H & N's Amchitka representative to comply with the August 18, 1969, request of the COE Anchorage area engineer. The AEC memorandum stated that equipment going to Adak and Seward "will be responsibility of contractor for all additional costs incurred in lieu of returning to Seattle."

Contract 0063, by its terms, specifically obligated defendant to transport plaintiff's equipment from Seattle to

Amchitka and to return the equipment to Seattle on a space available basis after 30 days' notice. The amount of time defendant is allowed to discharge its obligation to return plaintiff's equipment is not specified. It is well settled that where a time is not fixed in a contract for performance of an obligation, performance within a reasonable time, dependent upon the circumstances applicable, is required. Where no time limit is given, it is presumed that performance will be concluded within a reasonable time.[6]

All of plaintiff's equipment designated for return to Seattle in its August 13, 1969, request for a loading date was loaded on the September 13, 1969, barge and arrived in Seattle about September 29, 1969. The equipment that was designated off course to Adak was loaded on December 9, 1969, and delivered in Adak on December 10–11, 1969. Plaintiff's Seward-designated equipment was loaded on December 16, 1969, and, at plaintiff's direction, was delivered off course to Seward or returned to Seattle. This delivery schedule, in the circumstances, was reasonable and accords with defendant's contractual obligations.

After plaintiff's equipment was ready to be demobilized on August 10, 1969, five barges were available to be used: August 13, August 27, September 13, November 23, and December 9 or 16, 1969. Defendant elected to use the September barge for plaintiff's Seattle equipment and the December barge for the remainder.

Contrary to plaintiff's expectations, the August barge departed Amchitka on August 13, 1969, prior to receipt of a formal request for space. At the time the barge departed, the COE representative had given H & N's personnel verbal notice that plaintiff's equipment was ready, but had not authorized the equipment to be loaded. In a project as complicated as the Amchitka tests, with multiple Government agencies involved, it is unreasonable to assume that informal verbal requests, such as would be permissible in less complex projects that involved only the COE Anchorage area engineer, could be implemented on 2 days' verbal notice. The contract, by its terms, provided for 30 days'

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[6] *Societe Anonyme Des Ateliers Brillie Freres* v. *United States*, 160 Ct. Cl. 192, 201 (1963); 17 AM. JUR. 2d *Contracts* §§ 329–30 (1964).

notice. Defendant's failure to load plaintiff's equipment on the barge that departed August 13 is reasonable and cannot be the basis for breach of contract.

On August 24, a Foss barge, chartered by Christenson, Raber-Kief & Associates, Inc., for a trip from Adak to Shemya and return, was passing Amchitka and would either return to Adak or to Seattle. C-R-K's charter terminated when the barge returned to Adak or was abeam of Adak, en route to Seattle. Plaintiff notified the COE Anchorage representative and personnel of the other agencies on Amchitka that this barge could be made available if the Government would bear the cost of loading and lashing at Amchitka. No additional transportation costs were discussed. Defendant, however, did not accept plaintiff's offer. H & N had a contract with Foss to provide all of the barge transportation needed for the Amchitka project, and, at that time, additional barge space was not needed for project transportation requirements. Moreover, the charter rate for the C-R-K barge was greater than the charter rate H & N had arranged with Foss. Defendant had no obligation in August to make special efforts outside its normal routines to return plaintiff's equipment. It was not necessary, in August, to provide space in addition to the next barge regularly scheduled for September. The COE representative told plaintiff the C-R-K barge was declined because another barge would be available in early September, and that then there would be space available for all of plaintiff's equipment because very little material would be leaving Amchitka before the October test.

If plaintiff had an extraordinary need to return the Adak equipment in August, in view of its relationship to C-R-K & Associates, it would have ordered the C-R-K barge into Amchitka at its own expense. This was the procedure by which the equipment originally was brought to Amchitka from Adak. In such event, a contract adjustment could have been the subject of negotiations with the COE to give effect to the transportation provisions of the contract.

The September barge departed Amchitka on September 13, 1969, loaded only with the equipment of plaintiff and of other contractors that was designated for return to Seattle. There was ample space available to carry all of plaintiff's

equipment, including the equipment designated for off course to Adak and Seward, in addition to the equipment of other contractors that was being returned to Seattle. The AEC Las Vegas office directed H & N to stop loading at the end of free demurrage time after all Seattle-destined cargo was on board. Plaintiff's Adak- and Seward-designated equipment was not loaded, by direction of the AEC, because plaintiff had not provided formal written arrangements to AEC, to H & N, or to COE to cover payment for the diversions. There was no priority cargo on the September 13 barge, and no operational reason precluded the barge from carrying, in addition to the Seattle equipment, plaintiff's Adak-bound and Seward-bound equipment. The barge departed at the conclusion of its 96 hours of free demurrage allowed by H & N's contract with Foss. If the September barge had remained in Amchitka long enough to load all of plaintiff's equipment, it would have accrued demurrage for 1 or 2 days at the rate of approximately $2,000 per day.

Plaintiff's claim turns on the contractual significance of AEC's decision not to have H & N load plaintiff's Adak- and Seward-destined equipment on the September 13, 1969, barge. The AEC decision not to load was the result of confusion in communications between plaintiff's and defendant's representatives. Plaintiff's request for off-course diversions was a departure from literal provisions of the contract and plaintiff's imprecise method of operations generated the confusion that arose. Plaintiff knew, or should have known, in the factual situation that existed after the August 18 letter of the COE and the August 27 memorandum of AEC, Amchitka, to H & N, Amchitka, that additional specific information should be provided to AEC and to H & N before the September 13, 1969, barge was loaded. In the absence of written arrangements between plaintiff and the COE for diversions during demobilization, the consequences of plaintiff's failure to provide the additional information or to take other actions adequate to remove the confusion must be borne by plaintiff.

The COE's August 18 letter requested special consideration for loading of plaintiff's Seattle-destined equipment

because of contractual commitments in Seattle. Separation of the Seattle-bound equipment, which was sought by plaintiff, from the Adak- and Seward-bound equipment, warrants the different treatment by AEC and H & N for the two categories when the September 13 barge was loading. A copy of the August 18 letter was sent to plaintiff's Seattle office.

The AEC memorandum of August 27, which also was sent to plaintiff's Seattle office, notified H & N in Amchitka that plaintiff was responsible "for all additional costs incurred" for the equipment that was not returned to Seattle. In the circumstances, it was incumbent on plaintiff to do more to clarify its arrangements with the COE if it wanted the Adak and Seward equipment loaded on the September 13, 1969, barge.

Plaintiff, however, made no special effort between September 1 and September 13 to have the Adak and Seward equipment loaded. The COE's request on the Seattle-bound equipment was not clarified. Plaintiff's Amchitka personnel did not take steps to assure H & N's Amchitka personnel's loading of the Adak and Seward equipment. Plaintiff was experienced in barge transportation and scheduling and had personnel on site. More effort was needed to accomplish arrangements that were departures from those provided by the contract.

At trial, defendant's AEC witness testified the AEC did not know that the COE contracting officer's representative had agreed plaintiff could arrange to pay Foss directly for off-course diversions. Plaintiff knew that the only function of the COE, in the overall program, was to make requests to H & N, the AEC contractor responsible for scheduling transportation, and that H & N would not act on informal requests from plaintiff. Plaintiff, in the circumstances, had the obligation to either formally amend its contract with the COE, or to secure some formal expression of its special arrangements with the COE that would serve as a basis to impute such knowledge to the AEC.

Failure to load plaintiff's Adak and Seward equipment on the September 13, 1969, barge was a reasonable result of the existing record and of plaintiff's failure to take additional action. Since all of plaintiff's equipment designa-

ted in the August 13 and 14 letters for shipment to Seattle was shipped within the 30-day contract requirement, no breach of contract occurred from the September 13, 1969, shipment.

In late September, evacuation from Amchitka Island of all nonessential personnel began in preparation for the underground nuclear test on October 2, 1969. After the detonation, a period was required to determine that the island and the facilities were safe from radiation, and, as a consequence, there was no barge transportation in October 1969. No breach of contract can be based on a failure to load and return in October plaintiff's remaining Adak and Seward equipment.

When normal activities were resumed, following the test, southbound traffic increased substantially because considerable amounts of equipment and scientific apparatus had to be retrograded. The barges returning to Seattle were fully laden. To accommodate the demand for space, two empty barges were sent from Seattle—one on October 15 and the second on November 15, 1969—to retrograde equipment.

The November 23 barge from Amchitka was fully laden. It carried scientific equipment which had been utilized to monitor the tests and which was needed elsewhere. Much of this equipment was carried in sealed vans and was of a top secret nature. Had it been diverted to other ports, additional personnel and security procedures would have been required. In addition, this barge held the Parr Company drilling rigs, subject to expensive rentals, and a large number of cement trucks.

None of plaintiff's equipment was loaded on the November barge. It would not have been reasonable, in the circumstances, to load this barge with plaintiff's low priority equipment, remove higher priority equipment, and divert it to other ports for plaintiff's convenience. Defendant's refusal to use the November 23 barge to return plaintiff's equipment was reasonable and does not constitute a breach of plaintiff's contract with the COE.

Plaintiff's remaining equipment was removed in December on the second barge specifically sent to retrograde equipment. At that time, there remained on Amchitka, in

addition to plaintiff's equipment, equipment of other contractors destined for Seattle and equipment that belonged to Chris Berg. Defendant was contractually obligated to return the Chris Berg equipment to Seward.

In order to assure removal of all equipment remaining on Amchitka with one barge, a special round trip was made from December 9 through December 12 from Amchitka to Adak to return plaintiff's Adak-designated equipment. On this trip, plaintiff's Adak equipment was the only cargo on board. Plaintiff did not request this special round trip to Adak for its equipment, and the December 4, 1969, letter from H & N to Foss relative to diversion into Adak to accommodate the COE contractors, shows that the special round trip to Adak was for the convenience of defendant.

Defendant has counterclaimed for the full cost, $4,178.50, of the round trip to Adak. Had the barge been diverted off course into Adak, in accordance with plaintiff's request and defendant's original plan, the cost would have been approximately $1,849.50. Inasmuch as the round trip was for defendant's benefit and convenience, plaintiff only is chargeable with the costs that would apply to a diversion into Adak.

Upon its return to Adak, the barge was loaded with plaintiff's equipment bound for Seward and Seattle, Chris Berg's equipment consigned to Seward, and other contractors' equipment bound to Seattle. The barge departed Amchitka on December 16, 1969. About five lifts of plaintiff's equipment was unloaded at Seward and the majority, at plaintiff's request, was returned to Seattle. Defendant paid the entire cost, $12,007.75, of the off-course diversion into Seward. Defendant does not seek from plaintiff any counterclaim for a pro rata share of the costs for the off course into Seward.

In summary, defendant scheduled and loaded on September 13, 1969, within the 30-day provision of the contract, all of the equipment plaintiff originally had designated for return to Seattle. Had plaintiff not sought arrangements special under the contract, all of plaintiff's equipment could have been loaded and returned to Seattle at that time. Defendant's delay in removing the balance of plaintiff's equipment from Amchitka until December is

Syllabus

reasonable on the facts of this case. Plaintiff knew the function of the COE in the AEC test program and the COE had no obligation to secure a special barge, apart from the activities of H & N, to demobilize plaintiff's equipment to Adak and Seward. Departures from the literal terms of the contract, manifest only by informal arrangements based on personal relationships, are not reasonable in a project as complex as the Amchitka test program and are not the basis for breach of contract damages. Plaintiff was experienced and should have protected its interests by formal amendment to the contract or, at least, by contemporaneous correspondence with the COE that made clear what the parties intended with respect to off-course diversions on demobilization.

CONCLUSION OF LAW

Upon the trial judge's findings of fact and the foregoing opinion, which are adopted by the court, the court concludes as a matter of law that plaintiff is not entitled to recover and that the defendant is entitled to recover $1,849.50 on its counterclaim. Judgment is entered for defendant in that amount and the petition is dismissed.

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572 F.2d 820

BLAKE CONSTRUCTION CO., INC. v. THE UNITED STATES

[No. 274–73. Decided February 22, 1978]

ON THE PROOFS

Taxes; income tax; deductions; trade or business expenses; acquisition, maintenance and liquidation of horse racing stable; reasonableness of compensation for services; family corporation.—Plaintiff is a family corporation engaged in construction contracting, real estate and related activities, and at the time of trial was owned by three brothers, principal officers of the corporation and the sons of the founder, who died in December 1966. Just prior to the father's death, the brothers as an accommodation to the father caused the corporation to purchase the father's unprofitable horse racing and breeding stable. Losses which resulted from the undertaking were of no

use to either the father or the sons, but were utilizable by the corporation. This suit for refund of income taxes paid for fiscal years ending April 30, 1967 and 1968 involves the issue of whether the expenses of the stable were those of the plaintiff as a trade or business under Sec. 162 of the Internal Revenue Code of 1954 or were personal expenses of the corporate shareholders, and also the issue of whether $30,000 of the $90,000 salary paid in 1967 to each brother was reasonable compensation under Sec. 162 of the Code or was rather a constructive dividend to stockholders. On the evidence before the court, it is *held* that the stable owned by plaintiff corporation was not held as a trade or business and the losses and expenses thereof are therefore not ordinary and necessary business expenses. It is also *held* that the $30,000 excess salary paid to the brothers was a constructive dividend and not an ordinary and necessary business expense of plaintiff. Plaintiff is not entitled to recover and the petition is dismissed.

Taxes; income tax; deductions; expenses, trade or business; generally.

[1] A venture for profit is the hallmark of a trade or business in determining whether a taxpayer may deduct expenses paid or incurred during his taxable year.

Internal Revenue ⚖557

Taxes; income tax; deductions; expenses, trade or business; family corporation; horse racing and breeding stable purchase.

[2] A family corporation, controlled by three brothers and engaged in construction contracting, real estate and related activities, which purchased the father's unprofitable horse racing and breeding stable, is not entitled to a deduction for losses sustained in the acquisition, maintenance and liquidation of the stable under 26 U.S.C. § 162(a) or to a depreciation deduction under 26 U.S.C. § 167(a), where the purchase was made without consideration of any business aspects of stable ownership or of the possibility of profit but as an accommodation to their dying father, no advice on horse ownership was sought, management was left to an individual without direction, and the purchase was a means of corporate utilization of tax losses which were of no use to the father or the brothers as individuals.

Internal Revenue ⚖557, 721

Taxes; income tax; deductions; expenses, trade or business; compensation or salaries for services; family corporation.

[3] The reasonableness of compensation paid to corporate officers is an issue to be determined on all the facts and circumstances. Where the officers of a family-owned corporation voted themselves a specific salary annually, but were inadvertently paid half again as much in the taxable year in issue and made no effort to rectify the mistake, and the only evidence presented was the brothers' belief that they were worth the additional amount because they were required to lend their personal credit to obtain performance bonds on construction contracts awarded plaintiff, the excess compensation has not been proven to be reasonable

as an ordinary and necessary corporate business expense but represented a constructive dividend.

Internal Revenue ⊂⊃572

Gerald H. Sherman, attorney of record, for plaintiff. *A. L. Suwalsky, Jr.*, and *Silverstein and Mullens*, of counsel.

Robert S. Watkins, with whom was *Assistant Attorney General M. Carr Ferguson*, for defendant. *Theodore D. Peyser*, of counsel.

Before DAVIS, KASHIWA and KUNZIG, *Judges*.

PER CURIAM: This case comes before the court on plaintiff's exceptions to the recommended decision of Trial Judge David Schwartz, filed March 31, 1977, pursuant to Rule 134(h), having been submitted to the court on the briefs and oral argument of counsel. Upon consideration thereof, since the court agrees with the trial judge's recommended decision, as hereinafter set forth*, it hereby affirms and adopts said decision as the basis for its judgment in this case. In adopting the trial judge's opinion, conclusion and findings, the court stresses that this taxpayer was a very closely held family corporation, not one with a substantial number of public stockholders or a wide diversification of ownership. That fact is essential to our decision. It is, therefore, concluded as a matter of law that plaintiff is not entitled to recover and the petition is dismissed.

OPINION OF TRIAL JUDGE

SCHWARTZ, *Trial Judge:* The first of the two issues in this suit for a refund of income tax is whether the expenses of a stable of thoroughbred racing and breeding horses were those of a "trade or business" under section 162 of the Internal Revenue Code, 26 U.S.C. 162 (a) (1970), or were personal expenses of the shareholders of the plaintiff. The second issue is whether $30,000 of the $90,000 salary paid

* Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed March 31, 1977, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

in 1967 to each of the three executives of the plaintiff was reasonable compensation under § 162 or was rather a constructive dividend to stockholders. Both issues are on the facts found after trial decided against the taxpayer.

Plaintiff is a family corporation founded by Mr. Jack I. Bender in 1947 and engaged in general construction contracting, the ownership, management and development of real estate and related activities in and about the District of Columbia. It is a substantial company, with assets of over $100 million in the years involved, the fiscal years ending April 30, 1967 and 1968. Mr. Bender, who had been the chief executive officer, died on December 8, 1966, and his three sons, Morton A., Howard M. and Stanley S. Bender assumed exclusive control of the company, as working heads, officers and directors. At that time they each owned 15 percent of the stock, with most of the remainder in the hands of their father's testamentary marital trust. At the time of trial, the three brothers owned all of the stock.

Morton A. Bender, who had been his father's assistant and understudy, has been president from mid-1966, Howard M. Bender, the vice-president, attends to construction in the field, and Stanley S. Bender, the company's treasurer, sees to finance.

I. The Stable of Horses as a Trade or Business In Plaintiff's Hands

Mr. Jack Bender had a long-time interest in thoroughbred horse breeding and racing. He shared ownership of a large breeding farm, Glade Valley Farms, Inc. in Frederick, Maryland, with a prominent veterinarian and horse breeder, Dr. Robert A. Leonard, and he owned a stable of 12 thoroughbred horses, called J.I.B. Farms, which he raced and bred. J.I.B. Farms is the subject of this issue. In most years Mr. Bender's tax returns, never in this respect challenged by the Internal Revenue Service, showed substantial losses from the operation of J.I.B. Farms:

1959	($ 7,840) loss	1963	($ 60,621) loss
1960	(23,086) loss	1964	5,698 profit
1961	(24,103) loss	1965	3,237 profit
1962	(43,272) loss		

The stable of horses was sold by Mr. Bender to the plaintiff corporation on November 15, 1966. In that year his loss for the 11 months was $66,031.

Stanley Bender, acting for the plaintiff corporation, bought J.I.B. Farms from his father in November 1966 when the latter was in the hospital and both knew that he would not recover. The sale was agreed during a short discussion between the two. Stanley later told his brothers and they concurred. The bill of sale, dated November 15, 1966, gives the price as $177,804. Mr. Bender then owed the plaintiff $121,851 on a note.

The price was set by a valuation of the horses by a nationally-known firm of horse appraisers. The senior Mr. Bender's adjusted basis for the horses at the time was almost $205,000 more than the sale price. Before continuing with the subject of the sale to plaintiff, it may here be added that the plaintiff held the horses for 3 years, considered liquidation throughout that time and sold the horses at auction in 1969 for $63,500. Claimed tax losses, from operations and on liquidation, were considerable.

Mr. Bender's motive in selling was to provide for the welfare of the horses. His will had provided that his executors could sell the horses to Glade Valley Farms, but only at book value. Presumably he knew that their value was so much less than book that Dr. Leonard, the surviving half-owner, would not be willing to buy them at that price. In any event Mr. Bender wanted to sell the horses so that they would not on his death pass into the custody and care of an estate. This was an important consideration for Stanley, too, in agreeing to buy the horses.

The purchase of a horse racing and breeding stable by the plaintiff corporation was within the powers allowed to the corporation by its charter. But withal it was somewhat inappropriate for a company involved in real estate. The

plaintiff would not have bought anybody else's horses. The brothers were buying only their father's horses, but buying them for the corporation.

The stable would not have been as out of place for purchase by the brothers, individually, as it was for the corporation. The brothers own or have owned a radio station, a hotel, a retail store selling souvenirs of the Washington Redskins and various oil and gas properties. But those ventures they have engaged in for profit, and there were only losses to be expected from the horses they were buying to please their dying father.

Neither the purchase nor the operation by plaintiff of J.I.B. Farms was attended by any of the characteristics of a venture for profit, the hallmark of a trade or business. *Iowa State Univ. of Science & Technology* v. *United States*, 205 Ct. Cl. 339, 361–62, 500 F.2d 508, 522 (1974); *Patterson* v. *United States*, 198 Ct. Cl. 543, 552–53, 459 F.2d 487, 493 (1972); *cf.* § 269 I.R.C., 26 U.S.C. 269 (1970). The purchase was made without consideration of any business aspects of stable ownership and no thought was given, after the purchase, to the possibilities of profit. None of the brothers was familiar with horse management. Yet no advice on horse ownership was sought and management of the horses was left to Dr. Leonard without direction or goals, or indeed, without it being conveyed to him that he was now in sole charge.

The brothers knew that their father had been active in the management of the stable and given it direction and control as to purchases, breeding, racing and disposition of horses, but they did not supply either interest, management or plan. None of them participated in the management of the stable in the 3 years in which their corporation owned the horses. In the opinion of Dr. Leonard, who testified as a witness, he would have managed it differently if he had been told he was in sole charge. He thought that the stable had a profit potential if someone had given it overall direction. But no one did.

The neglect of an enterprise does not disqualify it from deductibility of its expenses, but the neglect here shown corroborates the inference from the facts that the cor-

porate purchaser was not buying a business but that the stockholders were doing a favor for their father.

Aside from the desire of the brothers to satisfy their father's concern for the welfare of his horses, there were significant tax aspects to acquisition by the corporation and not by the brothers individually. In view of the steady decline in the value of the horses, the sale whether to plaintiff or anyone else was inevitably to be a sale at a substantial loss. There were also steady losses to be expected, as in the past.

The senior Mr. Bender could not use such losses. He had substantial current operating losses in his various real estate partnership interests. Nor could the brothers individually use any losses. They, too, had such extensive losses on individual investments as made it unattractive to take over assets with existing or prospective losses.

But the plaintiff corporation could use losses, for it had plenty of income at the time. And while the loss suffered by Jack Bender on the sale of the horses to his family corporation could under section 267(a) of the Internal Revenue Code not be taken by the seller in the year of the sale, the plaintiff's accountant, who was also the family accountant, believed (and this belief the parties have agreed was erroneous) that the loss could under § 267(d) be taken by the corporation upon a resale to an unrelated third party. Accordingly, on plaintiff's tax returns, the accountant increased the losses on horses disposed of to the extent of Mr. Jack Bender's unrecovered basis.

The expectation of losses on ultimate sale was fully realized. Their value declined steadily from Jack Bender's cost basis of $383,000 to the appraised sale price of $177,804 and finally to the auction sale price of $63,500. The brothers considered liquidation of the horses during the entire period of plaintiff's ownership and actually decided to liquidate the stable when the plaintiff began in 1968 to sustain large losses.

In addition to the losses on the ultimate sale, so long as the plaintiff owned the horses there were to be expected substantial expenses and depreciation. These amounted, on plaintiff's tax return, to losses of $35,000 in the 5 months from the date of purchase, November 15, 1966, to the end of

the corporate fiscal year on April 30, 1967, and $134,000 in plaintiff's next fiscal year. Depreciation of such horses is considerable. The useful life for depreciation purposes of a racehorse is 5 years, and broodmares are depreciated through age 14. All of the horses acquired by plaintiff were depreciated on the basis of a 5-year useful life without regard to age or status—that is, whether they were racing stock or were used for broodmares.

There were thus tax motives for the purchase by the corporation, namely, first, the use of the annual losses of J.I.B. Farms to absorb profits of the plaintiff corporation and, second, the utilization of a $205,000 loss which was, or was believed to be, not useful to Jack Bender or to the brothers individually, but useful to plaintiff when plaintiff should resell the horses to an unrelated party. In Stanley Bender's words, the brothers considered the purchase a moving of the horses from one pocket to another.

The circumstances of the purchase and the subsequent treatment of the horses, set out in fuller detail in the accompanying findings of fact, are such as more than suggest that the three brothers caused the corporation to buy the horses, not as a business venture for profit or for the production of income but as an accommodation to their father, to make his mind easy as to the welfare of his horses, and as a means of utilizing tax losses which were of no use to their father and themselves as individuals. *Iowa State Univ. of Science & Technology* v. *United States, supra; Patterson* v. *United States, supra; cf.* § 269 I.R.C., 26 U.S.C. 269 (1970). The horses having been bought and held for a combination of filial sentiment and tax reasons and not as a trade or business for profit, the claimed losses and deductions from their ownership and liquidation may not be recognized under sections 162 and 167(a) of the Internal Revenue Code.*

* It is possible that corporate losses deductible under I.R.C. § 165(a) need not be shown to be business or profit-related. *Cf. International Trading Co. v. Commissioner*, 484 F.2d 707 (7th Cir. 1973); *W.L. Schautz Co. v. United States, ante* at 179. However, this taxpayer never raised this point throughout these proceedings but has consistently agreed that it could not prevail if the court found that it had no intention or purpose to make a profit on the horses. Accordingly, we do not pass in this case on the lurking issue of non-business-profit losses under § 165(a). [footnote by the court].

II. The Compensation Issue

The compensation issue arises from the circumstance that the three brothers as corporate officers set their salaries at $60,000 annually, but were inadvertently paid $90,000 in the corporation's fiscal year ending April 30, 1967. They each received $60,000 in each of the calendar years 1966 and 1967, but large payments in January and April of 1967 raised to $90,000 the total payment to each of them in the 12 months ending April 30, 1967. When the plaintiff in that fiscal year sought to deduct the whole $90,000 for each brother, the Commissioner disallowed $30,000, a total of $90,000 for the three brothers.

The issue is the reasonableness of the payment of $90,000 as compensation, an issue to be determined on all the facts and circumstances. *Jones Bros. Bakery, Inc.* v. *United States*, 188 Ct. Cl. 226, 231, 411 F.2d 1282, 1285 (1969); *Boyd Constr. Co.* v. *United States*, 168 Ct. Cl. 579, 586, 339 F.2d 620, 624 (1964).

The sums paid to each brother, in the years 1967 through 1968, were these:

1965	
January	$18,000
February	1,250
March	1,000
April	1,000
May	1,250
June	1,000
July	1,000
August	1,250
September	1,000
October	1,250
November	1,000
December	21,000
total, calendar year ending 1965	$50,000

1966			
January	$1,250		
February	1,000		
March	1,000		
April	18,000		
		total, corp. fiscal year	
May	1,250	ending April 1966	$50,000
June	4,000		
July	1,000		
August	18,250		
September	1,000		
October	1,250		
November	1,000		
December	11,250		
		total, calendar year ending 1966	$60,250

1967			
January	$31,000		
February	1,000		
March	1,000		
April	18,000		
		total, corp. fiscal year	
May	1,250	ending April 1967	$90,000
June	1,000		
July	1,250		
August	1,000		
September	1,000		
October	1,250		
November	1,000		
December	1,000		
		total, calendar year ending 1967	$59,750

1968			
January	$48,250		
February	1,000		
March	1,000		
April	1,250		
		total, corp. fiscal year	
May	1,000	ending April 1968	$60,250
June	1,000		
July	1,250		
August	1,000		
September	1,250		
October	1,000		
November	1,000		
December	1,250		
		total, calendar year	
		ending 1968	$60,250

It will be noted that their salaries in calendar 1965 were $50,000 and in calendar 1966 and 1967 and 1968 were $60,000 or substantially so, and that their salaries in the corporation fiscal year 1966 were $90,000 and in the corporation fiscal year 1967 were $60,250. Thus salaries were the same in the corresponding calendar and corporation fiscal year, except that each was paid $60,000 in calendar 1966 and $90,000 in the corresponding corporation's fiscal year, the year ending April 1967:

Calendar Year		*Corporation's Fiscal Year*	
1965	$50,000	1966	$50,000
1966	60,250	1967	90,000
1967	59,750	1968	60,250
1968	60,250		

Stanley Bender, in charge of finance for plaintiff, was well aware of the significance of the corporate fiscal year in connection with payment and deductibility of executive compensation. He had caused an $18,000 payment to be made to each of the brothers in April of 1966, the previous year, so that the total intended salary would be paid and

become deductible in the corporation's fiscal year. The payments of $90,000 instead of $60,000 in the fiscal year 1967 was a mistake, pure and simple. His mistaken payment to his brothers and himself of $30,000 more than was intended grew out of the custom of giving each brother, routinely, weekly checks on account of salary to a total of $1,000 or $1,250 per month and a larger check for any additional salary any one of them wanted to draw. Such a large sum—$31,000—had been paid to each brother in January 1967. In April, at the close of the corporation's fiscal year, Stanley Bender apparently overlooked the $31,000 payment in January, and perhaps with the thought of repeating the payment of $18,000 in the previous year, caused a check for $18,000 to be drawn to each brother, bringing the total for each brother, in the corporation's fiscal year, to $90,000.

When the mistake was discovered, some months later, no steps were taken to rectify it, because, the brothers testified, they believed they were worth the $90,000 they had been paid. Their belief was and is based on the fact that they are often required to pledge their personal credit to obtain performance bonds on large construction contracts awarded to the plaintiff corporation by the Government. Although the corporation had assets of over $100 million in the years in question, bonding companies would either not issue bonds or would charge a higher premium, without the signatures of the three brothers as individual guarantors of the corporation's obligation. At the time of trial there was in force a bond for the performance by plaintiff of a $110 million project at Walter Reed Hospital. To obtain the bond, all three brothers had been required to give personal guarantees.

In the years in issue the brothers owned 45 percent of the stock of the plaintiff and had individual assets of $5 to $6 million each. They were the only stockholders so required to guarantee the plaintiff's bonds. The other stockholders—the marital trust, Mrs. Jack I. Bender and her brother, who owned a small amount of stock—were apparently inappropriate guarantors.

The foregoing was the total of the evidence on the subject of the reasonableness of the $30,000 compensation paid to

each brother. There is no evidence in the record as to how much it is reasonable to pay, in addition to an already set salary of $60,000, as compensation for the brothers' pledge of personal fortunes of $5 million to faithful performance of their company's construction projects. *Tulia Feedlot, Inc.* v. *United States*, 513 F.2d 800, 807 (5th Cir.), *cert. denied*, 423 U.S. 947 (1975). Indeed, there is no evidence on the subject of the compensation reasonably to be paid for the services the brothers perform as executives of a construction contractor. The plaintiff introduced no evidence whatsoever on the compensation issue, other than the brothers' belief that they deserved the $90,000 paid them because they were required to lend their personal credit to the company.

It is quite possible that the brothers were each worth $90,000. It is quite possible that if they had decided to pay themselves $90,000 each as compensation for their work as executives and their pledges of their personal fortunes, evidence could be found to support the payment as reasonable. But it is hardly proof of their $90,000 worth that having decided to pay themselves $60,000, they accidentally paid themselves $90,000 and now state their post facto belief that they deserved it. It is easy to join with the Commissioner in believing that payment of a raise of $30,000 in the last days of the year by reason of lapse of memory as to bookkeeping and arithmetic is not to be respected as much as a deliberate decision to increase annual pay. *Cf. Henderson Tire & Rubber Co.* v. *Commissioner*, 12 BTA 716 (1928). If, as the brothers assert, they were worth $90,000, it would be expected that they would have originally voted to pay themselves $90,000, or at least paid themselves $90,000 in the following year, deliberately.

What seems to have happened is that the overpayment was simply not taken seriously in what was after all a corporation owned by the three people involved. That is just what distinguishes a constructive dividend to shareholder-executives—treatment of the corporation as a pocket of its executives. Stanley Bender's remark on the horse stable side of the case—that the change in ownership was a change from one family pocket to another—also sums up the $30,000 overpayment.

Syllabus

The record provides insufficient evidence to show affirmatively, as a taxpayer seeking to overturn the Commissioner must, that $60,000 or $90,000 or any other sum is reasonable compensation under § 162(a)(1) of the Code. *Lewis* v. *Reynolds*, 284 U.S. 281, 283 (1932); *Missouri Pacific R.R. Co.* v. *United States*, 168 Ct. Cl. 86, 90, 338 F.2d 668, 671 (1964). On this issue, too, the plaintiff taxpayer fails in its proof, and the complaint must therefore be dismissed.

Conclusion of Law

Upon the foregoing opinion, the findings of fact and ultimate findings and conclusions, which the court adopts and which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover, and the petition is dismissed.

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571 F.2d 34

FRAASS SURGICAL MFG. CO., INC. v. THE UNITED STATES

[No. 343-73. Decided February 22, 1978]

ON THE PROOFS

Contracts; reformation; liability for loss of Government-furnished property; limitation of actions; unconscionability of contract clause.—During performance of a fixed-price contract for production of survival kits for the Air Force, Government-furnished material (GFM) on plaintiff's premises was destroyed by fire without fault of plaintiff. The contract imposed on plaintiff strict liability for losses of GFM by fire. Plaintiff made partial payment, under protest, and the Government withheld the balance from payments due under the contract. Plaintiff seeks refund of the amounts paid to and withheld by defendant, and requests reformation of the contract to replace the strict liability clause with a clause under which plaintiff would be liable for the fire loss only in case of fault or wrongdoing. Defendant asserts that the cause of action accrued more than 6 years before the present suit was filed, that is, when plaintiff received the Government's Advice of intent to withhold payment. It is *held* that the Government's Advice was non-final—a temporary postponement of payment—since it was issued pursuant to a letter authorizing "tentative withholding."

Syllabus

Accordingly, plaintiff's cause of action accrued no earlier than October 10, 1967 when, with a reservation of rights, it turned over to the Government its insurance company's check—within the 6-year statutory period prescribed by 28 U.S.C. § 2501. It is also *held* that under contract clause 60.1–3a(g), plaintiff is liable for the loss by fire of the GFM; the contract is within the contemplation of the terms of ASPR § 13–702, effective at the time, requiring that said clause be included in fixed-price contracts, and the Government did not make a mistake in including said clause. Plaintiff is therefore not entitled to reformation. It is also *held* that the clause was not unconscionable. Plaintiff is not entitled to recover and the petition is dismissed.

Contracts; limitation of actions; accrual of cause of action; money due under contract.

[1] A claim based upon a contractual obligation of the Government to pay money first accrues on the date when the payment becomes due and is wrongfully withheld in breach of the contract. Where the Government notified plaintiff of its plan to withhold payment because of loss by plaintiff of Government-furnished material, plaintiff's receipt of that advice cannot be considered as accruing the cause of action since the notification stated that the deduction was being made pursuant to a letter from the contracting officer "authorizing tentative withholding." Plaintiff was entitled to regard the action as non-final—a temporary postponement of payment.

Federal Courts ⚖1107

Contracts; reformation; mutual mistake.

[2] This court will normally grant reformation when there has been a mutual mistake of fact which causes the terms of a written contract to depart from the actual intention of the parties. In such a case, plaintiff must show that the Government would have agreed to the contract if worded in accordance with plaintiff's intention.

Reformation of Instruments ⚖19(1)

Contracts; reformation; grounds for reformation; generally.

[3] Failure to read a contract before signing does not necessarily foreclose reformation, since the gravamen of the reformation inquiry is whether the document reflects the agreement actually reached by the parties. However, a contractor who fails to read a Government-drafted proposed contract must still show a mistake by the Government before he can obtain reformation, since otherwise the mistake is not mutual.

Reformation of Instruments ⚖17(1)

Contracts; interpretation; fixed-price contract; Government-furnished property; strict liability clause.

[4] Where, in the award of a fixed-price contract, the contracting officer, within his discretionary authority, correctly determined that there was price competition sufficiently adequate to treat the procurement as exempt from the need to furnish certified cost and pricing data, absent evidence to the contrary, the contract was within the contemplation of the then controlling ASPR § 13.702 requiring inclusion of the strict liability clause holding a contractor liable for damage to or loss of

Government-furnished material, except where cost and pricing data were required to be furnished.

United States ⚖70(13)

Contracts; interpretation; unconscionable contract or clause; Uniform Commercial Code.

[5] An unconscionable contract clause is one which no man in his senses, not under a delusion, would make, on the one hand, and which no fair and honest man would accept on the other. The grant of discretion to deny enforcement to an unconscionable clause in Sec. 2–302 of the Uniform Commercial Code is not intended to permit courts to redistribute risks allocated by differences in bargaining power, but rather to prevent oppression and unfair surprise.

Contracts ⚖1

Contracts; interpretation; failure to read contract.

[6] A contractor's failure to read the terms of a contract, because prior contracts had contained a clause other than the clause actually contained, cannot be used as a defense to consequences of such an omission.

Contracts ⚖93(2)

Jacob H. Fischman, attorney of record, for plaintiff. *Norman Jacobson*, of counsel

Gerald L. Schrader, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

PER CURIAM: This case comes before the court on defendant's motion, filed November 10, 1977, under Rule 141(b), moving that the court adopt, as the basis for its judgment in this case, the recommended decision of Trial Judge David Schwartz, filed September 30, 1977, pursuant to Rule 134(h), plaintiff having failed to file a notice of intention to except or exceptions thereto and the time for so filing pursuant to the Rules of the court having expired. Upon consideration thereof, without oral argument, since the court agrees with the trial judge's recommended decision, as hereinafter set forth,* it hereby grants defendant's motion and adopts the said decision as the

* Whereas, the court adopts the trial judge's separate findings of fact, which are set forth in his report filed September 30, 1977, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

basis for its judgment in this case. Therefore, it is concluded as a matter of law that plaintiff is not entitled to recover and the petition is dismissed.

OPINION OF TRIAL JUDGE

SCHWARTZ, *Trial Judge:* This is an action for reformation of a contract in which plaintiff, a manufacturer of medical and surgical equipment, agreed to produce airmen's survival kits for the Air Force. Government furnished material (GFM) valued at $126,220 was present on the plaintiff's premises when the plant was destroyed by fire, without fault of the plaintiff. A clause in the contract imposed on the contractor strict liability for losses of GFM by fire. With a reservation of rights, plaintiff paid the Government $75,000 received as insurance proceeds, and the Government withheld the remaining $51,220 from payments due under the contract. Plaintiff sues for refund of the $126,220, praying that the court reform the contract to replace the strict liability clause with another clause under which the contractor would be liable for the fire loss only in case of fault or wrongdoing.

The case has previously been considered by the court on the Government's motion for summary judgment. *Fraass Surgical Mfg. Co.* v. *United States*, 205 Ct. Cl. 585, 505 F.2d 707 (1974). The court dismissed portions of the petition and remanded the case for trial of a disputed question of fact determinative of the time of accrual of the cause of action and thus of the defense of limitations; and if the action were not barred by limitations, for trial of the claim of mutual mistake said to warrant reformation. Plaintiff has since amended its petition to allege that the challenged clause is unconscionable and therefore unenforceable.

I The Statute of Limitations

Plaintiff instituted suit on September 21, 1973; the suit is therefore barred under the 6-year statute if the cause of action accrued before September 21, 1967. 28 U.S.C. § 2501 (1970). The standard for determination of the date of accrual was determined by the court in the earlier opinion.

"The claim first accrues on a claim for nonpayment of money," the court held, "on the date when payment becomes due and is wrongfully withheld in breach of the contract." *Fraass Surgical Mfg. Co.* v. *United States, supra,* 205 Ct. Cl. at 591, 505 F.2d at 710, quoting from *Oceanic S.S. Co.* v. *United States,* 165 Ct. Cl. 217, 225 (1964).

The fire which destroyed the property in question occurred on January 9, 1967. Following meetings with Government officers during January and February of that year, plaintiff resumed its performance of the contract in June. On August 24, the Government received plaintiff's invoice number 5854, apparently the first invoice since the fire. The Government claims that on September 15 it mailed an Advice of Payment form to plaintiff, notifying it that payment of $12,382.02, due on that invoice, was being withheld. The Government argues that receipt of this notice, which it is implied occurred before September 21, 1967, was the last event necessary to permit the plaintiff to bring suit as for a wrongful withholding. Accordingly, the court is asked to hold that the period of limitations began to run before September 21, 1967 and had expired when the suit was brought on September 21, 1973. The contention fails, for lack of notice to plaintiff of a firm withholding. The withholding pursuant to the Advice of Payment was tentative only. The Advice stated that the deduction was being made pursuant to a letter from the contracting officer of July 10, 1967, "authorizing tentative withholding." The evidence is that money withheld pursuant to such authority is placed in an escrow account pending a final determination of the amount to be withheld.

Receipt of the Advice, therefore, was not a notice of an accomplished offset as a withholding from contract payments which were due the plaintiff, such as would require it to bring suit. Plaintiff was entitled to regard the action taken as non-final—merely a temporary postponement of payment. A final statement by the Government of the amount of its loss was dated September 8 and was agreed to by plaintiff on September 21. On October 10, 1967, the plaintiff with a reservation of rights turned over to the Government its insurance company's check for $75,000,

reducing the balance due the Government to $51,220.38. On October 19, 1967, the remaining amount of the Government's claim was set off against payments due to the plaintiff on invoices for goods delivered, and payment was made to plaintiff of the balance due on the invoices. No payment by plaintiff or offset against sums due to plaintiff is therefore shown to have taken place earlier than October 10, 1967. Thus limitations had not expired when suit was brought on September 21, 1973.

II Reformation

Reformation is sought to rectify the alleged mistaken inclusion in the contract of clause 60.1–3a(g), allotting to the contractor the risk of loss by fire of Government furnished material.[1] Plaintiff urges that the parties intended to include a different clause, under which plaintiff would be liable only for loss by reason of fault or wrongdoing by its officers. Were the contract so reformed, plaintiff would prevail, for the fire took place wholly without its fault.

This court will normally grant reformation when there has been a mutual mistake of fact which causes the terms of a written contract to depart from the actual intention of the parties. *Fraass Surgical Mfg. Co.* v. *United States*, *supra*, 205 Ct. Cl. at 596, 505 F.2d at 713; *Space Corp.* v. *United States*, 200 Ct. Cl. 1, 8–9, 470 F.2d 536, 540 (1972); *Bromion Inc.* v. *United States*, 188 Ct. Cl. 31, 35, 411 F.2d 1020, 1022 (1969). The plaintiff in such a case must show, of course, that the Government would have agreed to the contract if worded in accordance with the plaintiff's intention. *Ling-Temco-Vought, Inc.* v. *United States*, 201 Ct. Cl. 135, 150–51, 475 F.2d 630, 639 (1973); *McNamara Constr. Ltd.* v. *United States*, 206 Ct. Cl. 1, 9–10, 509 F.2d 1166, 1170 (1975). A claim may also be stated by allegations

[1] The clause provides:

"Unless otherwise provided in this contract, the Contractor assumes the risk of, and shall be responsible for, any loss of or damage to Government property provided under this contract upon its delivery to him or upon passage of title thereto to the Government as provided in paragraph (c) hereof, except for reasonable wear and tear and except to the extent that such property is consumed in the performance of this contract."

of the occurrence of a mistake of which the Government knew or should have known and that the Government should be required to share in the loss as a matter of equity. *Burnett Electronics Lab., Inc.* v. *United States*, 202 Ct. Cl. 463, 472, 479 F.2d 1329, 1333 (1973) (collecting the cases); *Ruggiero* v. *United States*, 190 Ct. Cl. 327, 339–40, 420 F.2d 709, 715–16 (1970).

Here a different kind of mistake by each of the parties is alleged. The Government, presumed to have intended to include in the contract the clause which the regulations bound it to use (*Chris Berg, Inc.* v. *United States*, 192 Ct. Cl. 176, 426 F.2d 314 (1970)), is said to have chosen wrongly between the two clauses—strict-liability and liability-for-fault-only—specified in the Armed Services Procurement Regulation for two different types of contracts. Plaintiff's mistake, of a very different sort, is alleged to have occurred when plaintiff's president, relying on his recollection of past contracts with the Government, did not read the contract before he signed it, and thus did not notice that the wrong risk-of-loss clause had been included. Failure to read a contract before signing it does not necessarily foreclose reformation, since the gravamen of the reformation inquiry is whether the document reflects the agreement actually reached by the parties. *Chicago & N.W. Ry. Co.* v. *United States*, 68 Ct. Cl. 524, 538 (1929). On the other hand, a contractor who does not read the contract furnished him by the Government must still show a mistake by the Government before he can obtain reformation, since otherwise the mistake is not mutual. *See*, for example, *National Electronic Lab. Inc.* v. *United States*, 148 Ct. Cl. 308, 180 F.Supp. 337 (1960); *Schoeffel* v. *United States*, 193 Ct. Cl. 923 (1971); *Dale Ingram, Inc.* v. *United States*, 201 Ct. Cl. 56, 475 F.2d 1177 (1973).

Both clauses involved in the claim for reformation—the clause present in the contract and the clause plaintiff says should have been there—have their source in the version of ASPR § 13–702 in force at the time the contract was made. 32 C.F.R. § 13–702 (1966).

Subdivision (a) of ASPR § 13–702 directed the inclusion in fixed-price contracts of the clause actually in the instant contract, 60.1–3a(g), with an exception stated in subdivision

(b). Subdivision (b) provided that the less strict clause—making the contractor liable only for fault—should be included in "fixed price contracts under which the contractor is required to submit [the] certified cost or pricing data" provided for in ASPR § 3-807.3.[2] ASPR § 13-702, 32 C.F.R. § 13-702 (1966). In turn ASPR § 3-807.3, essentially a restatement of the Truth-in-Negotiations Act, 10 U.S.C. § 2306(f) (1970), provided that cost and pricing data should not be required where a negotiated contract is based on adequate price competition. 32 C.F.R. § 3-807.3 (1966).

The contract with the plaintiff was a fixed-price contract, presumptively subject to the direction of subdivision (a) of ASPR § 13-702 for the use of the clause actually used. Plaintiff's case is that the exception in subdivision (b) was nevertheless applicable because the contract was negotiated on inadequate price competition. Cost and pricing data, plaintiff contends, were therefore required to be furnished and were furnished by the plaintiff in the course of a pre-award survey. According to the Government, its officers intended to use the strict clause and were justified in doing so on the basis of a discretionary and correct judgment that there was adequate price competition such as exempted the contractor from the furnishing of cost and pricing data and thus from the application of subdivision (b) of ASPR § 13-702. Moreover, the Government denies that a pre-award survey was ordered or conducted and denies that plaintiff submitted certified cost and pricing data.

All these issues are determined against the plaintiff. The conclusion that the Government used the right clause and made no mistake makes it unnecessary to evaluate the

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[2] The parties are in dispute over whether Revision 18 of ASPR § 13-702, dated August 1, 1966, governs the contract. The Revision was to be effective 90 days after its issuance but its use before then was optional. The Request For Proposals in this case was issued on August 12, 1966, and the contract was let on September 20, 1966. The revision was not actually received in the procuring agency in time for it to be used in the preparation of the instant Request For Proposals, and its effective date came after the contract was awarded to plaintiff. In any event the revised regulation had the same effect for the present case as did the existing version. The revision merely incorporated the reference to "adequate price competition," formerly found in ASPR § 3-807.3, directly into the description in ASPR § 13-702 of the contracts in which the substitute risk of loss clause should be used. 32 C.F.R. § 13-702(b) (Jan. 1, 1967).

cause of action, to pass on plaintiff's claim of its own mistake, or to discuss such questions as the effect of the Government's non-compliance with any of the regulations involved.

On the first issue—that of adequate price competition—it appears that the item involved had been the subject of two prior procurements. The bidders list for the item showed 15 firms. On the distribution of the Request For Proposals to these firms, six responded with bids. The range of bids per unit was $11.97 (the plaintiff's bid), $12.20, $19.25, $23.89, $25 and $39.50. Two of the bidders, plaintiff and the firm which bid $23.89, were the former suppliers. On these facts, the assistant contracting officer and contracting officer determined that there was price competition sufficiently adequate to treat the procurement as exempt from the need to furnish certified cost and pricing data.

"Adequate price competition," is in ASPR § 3-807 defined as present if responsible bidders submit two or more responsive bids which can satisfy the Government's needs. The decision is expressly described as a matter of judgment for the contracting officer.[3] The contracting officer's decision on this point must be regarded as within

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[3] ASPR § 3-807.1 in part provides:

"(1) *Adequate Price Competition.*

a. Price competition exists if offers are solicited and (i) at least two responsible offerors (ii) who can satisfy the purchaser's (e.g., the Government's) requirements (iii) independently contend for a contract to be awarded to the responsive and responsible offeror submitting the lowest evaluated price (iv) by submitting priced offers responsive to the expressed requirements of the solicitation. Whether there is price competition for a given procurement is a matter of judgment to be based on evaluation of whether each of the foregoing conditions (i) through (iv) is satisfied. Generally, in making this judgment, the smaller the number of offerors, the greater the need for close evaluation.

"b. If conditions (i) through (iv) in a above are met, price competition may be presumed to be 'adequate' unless the purchaser (e.g., the contracting officer) finds that:

"(i) the solicitation was made under conditions that unreasonably deny to one or more known and qualified offerors an opportunity to compete;

(ii) the low competitor has such a determinative advantage over the other competitors that he is practically immune to the stimulus of competition in proposing a price (e.g., a determinative advantage because substantial costs, such as startup or other non-recurring expenses, have already been absorbed in connection with previous sales, thus placing the competitor in a preferential position); or

(iii) the lowest final price is not reasonable and supports such finding by an enumeration of the facts upon which it is based; provided, that such finding is approved at a level above the contracting officer."

his discretion, not to be overturned unless it is shown to be arbitrary, capricious, or an abuse of discretion. *Sperry Flight Systems, Inc.* v. *United States*, 212 Ct. Cl. 329, 339–348, 548 F.2d 915, 921 (1977). Plaintiff does not seriously challenge the decision of the contracting officer. No evidence is shown of a lack of price competition; the range of bid prices is of course not such evidence. On the other hand, the number and the range of bids and the presence of bids by two former suppliers are more than ample support for the discretionary conclusion of the officers in charge that there was adequate price competition, thus no occasion to demand certified cost or pricing data and thus no reason to use the less strict risk-of-loss clause.

Plaintiff's additional, supporting claims are likewise rejected, on the facts. Plaintiff's president testified at trial that a pre-award survey had been conducted and in a pretrial deposition that he could not remember whether there had been a pre-award survey. His testimony that he gave a rough and sketchy cost data sheet to two Government officers in the course of a pre-award survey is outweighed by the direct testimony of the contracting officer and his assistant that they did not request such data and that no pre-award survey was conducted in connection with this contract. The data allegedly furnished by plaintiff was obviously not the detailed and certified cost or pricing data contemplated by the regulation. Too, the regulation provides that the certified data shall be solicited by the contracting officer. ASPR § 3–807.3. It is found as a fact that no pre-award survey was conducted, and that certified cost or pricing data was not solicited and not furnished.

All of the arguments for the applicability of subdivision (b) of ASPR § 13–702 fail, and it therefore appears that the clause in the contract on the subject of liability for GFM was the correct clause. There was no mistake by the Government and thus no mutual mistake and no case for reformation.

Compare ASPR §§ 21–126 Item 18, Extent of Competition in Negotiation, setting out substantially the same definition for purposes of providing procurement statistics.

III Unconscionability

Plaintiff's final contention is that the strict risk of loss clause is unenforceable because it is unconscionable. According to an early definition, an unconscionable contract clause is one "which no man in his senses, not under a delusion, would make, on the one hand, and which no fair and honest man would accept on the other." *Hume* v. *United States*, 21 Ct. Cl. 328, 330 (1886), *aff'd* 132 U.S. 406 (1889). The grant of discretion to deny enforcement to an unconscionable clause in the modern Uniform Commercial Code's Section 2–302 is not intended to permit courts to redistribute risks allocated by differences in bargaining power, but rather to prevent oppression and unfair surprise. U.C.C. § 2–302, Official Comment 1.

There was here no surprise. Clause 3a(g) is there to be read, in print of the same size as the rest of the contract. Its language is quite clear, as contract clauses go—much clearer, for instance, than that of the less-than-strict liability clause plaintiff argues for. The testimony of plaintiff's president that he did not read the contract in 1966, because contracts that he had signed in 1963 and 1960 had contained the other clause, is irrelevant and unacceptable. He is an experienced businessman and should know better. *Richardson Camera Co.* v. *United States*, 199 Ct. Cl. 657, 467 F.2d 491 (1972).

Nor was the clause oppressive. It required only that plaintiff insure the goods. Plaintiff's failure to insure the goods for their full value—actually he reduced his insurance shortly before the fire—was no fault of the Government. Plaintiff says that the Government delayed shipping GFM and then shipped a very large amount, unfortunately in the plant at the time of the fire. It is not said why this was a legal wrong. Finally, a contention of unconstitutional discrimination against small contractors is frivolous. Contractors large and small can take out insurance when the premiums are defrayed by the Government's contract payments.

None of the attacks on the risk of loss clause are meritorious and the petition must be dismissed.

Syllabus

CONCLUSION OF LAW

Upon the foregoing opinion, the findings of fact and intermediate conclusions of fact and law, which the court adopts and which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover and the petition is dismissed.

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571 F.2d 1180

M.S. AND GERALDINE C. LEE v. THE UNITED STATES

No. 265–74

R.E. AND JANE S. LEE v. THE UNITED STATES

No. 266–74

[Decided February 22, 1978]

ON THE PROOFS

Taxes; income tax; interest deductions; loans secured by insurance policies.—In these consolidated cases the issue before the court is the deductibility for income tax purposes of amounts alleged by plaintiffs to have been interest payments made to an insurance company (Western) in 1966–1969 on loans secured by 63 life insurance policies, each for the face amount of $50,000, issued in 1962 by Western to plaintiffs as owners and beneficiaries. Each year during the 1962–1965 period, plaintiffs prepaid premiums on the insurance policies for the ensuing 4 years at a discounted rate, and then "borrowed" back from Western an amount representing the then-current cash surrender value of each policy, and used the money to pay the required additions to the prepaid premium funds and the interest charged by Western on the loans. In 1966, plaintiffs discontinued the prepayment of premiums and the prepaid premium fund was terminated. Thereafter, plaintiffs borrowed from Western each year an amount representing the then-current cash surrender value of each policy, and used the money to pay the premiums currently owed and the interest due on all the loans made by Western. It is *held* that, because the loan transactions in 1962–1965 were shams under the teaching of *Ballagh* v. *United States*, 166 Ct. Cl. 191, 331 F. 2d 874, *cert. denied*, 379 U.S. 887 (1964), plaintiffs are not entitled to deduct, as interest, payments made during 1966–1969 on the loans made in 1962–1965. The respective petitions are dismissed as to

such claims. It is also *held* that since the record shows that plaintiffs could not have afforded to pay during 1966–1969 the premiums without borrowing, and since the interest on bank loans to pay such premiums would be deductible, the interest on the 1966–69 loans obtained from Western was deductible. The amount of plaintiffs' recovery respecting this portion of the petitions will be determined pursuant to Rule 131(c).

Taxes; income tax; deductions; interest on indebtedness; loans secured by insurance policies; sham transaction.

[1] Where, during 1962–1965, under an arrangement with their insurer W, plaintiffs each year prepaid for several years premiums on their life insurance policies issued in 1962, and then borrowed back from W an amount representing the then-current cash surrender value of each policy and used the money to pay the required additions to the prepaid premium funds and the interest charged by W on the loans, such transactions were shams under *Ballagh* v. *United States*, 166 Ct. Cl. 191, 331 F. 2d 874 (1964), and the interest payments made during 1966–1969 on such loans are not deductible for income tax purposes.

Internal Revenue ⚖517

Taxes; income tax; deductions; interest on indebtedness; loans secured by insurance policies.

[2] Payments of interest made on loans from W for years 1966–1969 are deductible for income tax purposes where, during said years, there was no prepayment of premiums, plaintiffs would have been unable to pay the premiums absent the loans, and interest on bank loans for premium payment purposes would be deductible.

Internal Revenue ⚖517

Dee A. Replogle, Jr., attorney of record, for plaintiffs. *Robert H. Gilliland, Jr.*, and *McAfee, Taft, Mark, Bond, Rucks & Woodruff*, of counsel.

James L. Malone, III, with whom was *Assistant Attorney General M. Carr Ferguson*, for defendant. *Theodore D. Peyser* and *Donald H. Olson*, of counsel.

Before COWEN, *Senior Judge*, NICHOLS and BENNETT, *Judges*.

PER CURIAM: These cases come before the court on the exceptions of the parties to the recommended decision of Senior Trial Judge Mastin G. White, filed February 10, 1977, pursuant to Rule 134(h), having been submitted on the briefs and oral argument of counsel. Upon consideration thereof, since the court agrees with the trial judge's

recommended decision, as hereinafter set forth*, it hereby affirms and adopts the decision as the basis for its judgment in this case. It is, therefore, concluded that plaintiffs are entitled to recover (together with interest as prescribed by statute) insofar as their claims are based upon interest that was paid on loans obtained from Western Security Life Insurance Company during the years 1966, 1967, 1968, and 1969, and judgment is entered for plaintiffs to that effect. The amount of plaintiffs' recovery in each case will be determined pursuant to Rule 131(c).

The court further concludes that plaintiffs are not entitled to recover insofar as their claims are based upon interest paid on loans obtained from Western Security Life Insurance Company during the years 1962, 1963, 1964, and 1965, and the respective petitions are dismissed as to such claims.

OPINION OF TRIAL JUDGE

WHITE, *Senior Trial Judge:* R. E. Lee and Jane S. Lee, the plaintiffs in case No. 266–74, are husband and wife. M. S. Lee and Geraldine C. Lee, the plaintiffs in case No. 265–74, are also husband and wife. All the plaintiffs are residents of Oklahoma City, Oklahoma. (When the term "plaintiffs" is used hereafter in the opinion, it will refer to R. E. Lee and M. S. Lee unless the context plainly indicates otherwise, as Jane S. Lee and Geraldine C. Lee are parties to the litigation only because they signed joint income tax returns with their respective husbands.)

The issue before the court in the two cases—which were consolidated for trial purposes, as they involve similar facts and identical questions of law—relates to the deductibility for income tax purposes of amounts alleged by the plaintiffs to have been interest payments made to Western Security Life Insurance Company ("Western") in 1966, 1967, 1968, and 1969 on loans secured by life insurance policies which Western had issued to the plaintiffs in 1962.

* Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed February 10, 1977, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

On July 1, 1962, the plaintiffs purchased a total of 63 so-called "Executive Special" life insurance policies from Western, an Oklahoma City company. These policies were whole life policies (as distinguished from term policies or endowment policies), and each was for the face amount of $50,000.

Plaintiff R. E. Lee purchased 30 of the insurance policies mentioned in the preceding paragraph. He was the owner, policyholder, and beneficiary of each of the 30 policies. Six of the policies were issued on the life of R. E. Lee himself, six policies were issued on the life of his wife, Jane S. Lee, and six policies were issued on the life of each of their three children, Robert E. Lee II, Linda Jane Lee, and Terry Lou Lee.

Plaintiff M. S. Lee purchased 33 of the 63 life insurance policies previously mentioned. He was the owner, policyholder, and beneficiary of each of these 33 policies. Six of the policies were issued on the life of M. S. Lee, three policies were issued on the life of his wife, Geraldine C. Lee, and six policies were issued on the life of each of their four children, Stanley W. Lee, Larry K. Lee, Richard C. Lee, and Claudia Lee.

As required by Oklahoma law, each of the 63 life insurance policies contained a provision granting the policyholder the right to obtain from Western at any time, on the sole security of the policy, a loan in an amount not exceeding the then-current cash surrender value of the policy, such loan to bear interest at the rate of 4 percent per annum. The loan provision of each policy further stated, in accordance with Oklahoma law, that the failure of the policyholder to repay the principal of, or to pay the interest on, any such loan or loans would not void the policy so long as the total amount due did not exceed the cash surrender value of the policy.

The plaintiffs took full advantage of the loan provisions of the several policies by utilizing every year the full amount of the then-current cash surrender value of each policy. The mechanics of such utilization, and the issue presented by the litigation, can be illustrated by taking the six life insurance policies on the life of Terry Lou Lee as an example, and outlining the relationship between R. E. Lee

(the father of Terry Lou Lee and the owner of the Terry Lou Lee policies) and Western with respect to such policies.

It is necessary to note at the outset that during the 1962–65 period—which preceded the period that is actually involved in the present litigation—the relationship between R. E. Lee and Western with respect to the six Terry Lou Lee policies involved a situation which was similar to the situation that was before this court in *Ballagh* v. *United States*, 166 Ct. Cl. 191, 331 F. 2d 874 (1964), *cert. denied*, 379 U. S. 887 (1964).

Each of the six $50,000 policies insuring the life of Terry Lou Lee called for an annual premium of $2,971 for the first 20 years, and $471 per year beginning in the 21st year of the policy and continuing indefinitely thereafter. In the first year, 1962, R. E. Lee paid to Western: (1) $17,826 to cover the first annual premiums due on the six policies for the 1-year period beginning July 1, 1962; (2) $66,261 representing the then-present value of the next 4 years' premiums on the six policies, discounted at 3 percent; and (3) $3,329.94 as "interest" on the amount of $83,248.62 "borrowed" by R. E. Lee from Western contemporaneously under the arrangement described in the next succeeding paragraph of this opinion. The prepaid premium fund of $66,261, when supplemented by the interest to be earned thereon at the rate of 3 percent per annum, was sufficient to pay the next four annual premiums as they became due on the six Terry Lou Lee policies.

Contemporaneously with the payments from R. E. Lee to Western mentioned in the preceding paragraph, R. E. Lee "borrowed" $83,248.62 from Western on the six Terry Lou Lee policies at an annual interest rate of 4 percent. This "loan" consisted of the entire first-year cash surrender values of the six Terry Lou Lee policies ($15,000), plus the prepaid premium fund as supplemented by interest on such fund ($68,248.62).

In each succeeding year after 1962, extending through 1965, R. E. Lee replenished the prepaid premium fund by making an advance payment of the premiums due 4 years later, discounted at 3 percent, or a total of $15,838.40. In accordance with the terms of the policies insuring the life of Terry Lou Lee, Western credited each year to the

guaranteed cash value account of the six Terry Lou Lee policies the entire increase in the cash surrender values of the Terry Lou Lee policies. This amount was always greater than the $15,838.40 added to the prepaid premium fund; and R. E. Lee would use this amount, advanced to him as a "loan" by Western, together with other out-of-pocket amounts, to pay (1) the addition to the prepaid premium fund in full and (2) the annual 4 percent "interest" charged by Western on the increasing indebtedness to Western under the policies. As a result of these "loan" transactions, the six Terry Lou Lee policies owned by R. E. Lee never had any unused cash surrender value during the 1962–65 period.

Ballagh v. *United States, supra,* involved a loan transaction between a policyowner and an insurance company that featured the prepayment of premiums and then borrowing back the same amount from the insurance company, at interest. That is essentially what happened between R. E. Lee and Western with respect to the Terry Lou Lee policies during the 1962–65 period. In the *Ballagh* case, this court said (166 Ct. Cl. at 198, 331 F. 2d at 878) that the loan transaction was a "sham" and that the purported interest payments that were made as part of the loan transaction should be disregarded for income tax purposes.[1]

In accordance with the *Ballagh* decision, it would be necessary to hold that the purported interest payments which R. E. Lee made to Western during the 1962–65 period on the loans from Western under the Terry Lou Lee policies were not deductible for income tax purposes, if the deductibility of such payments were before the court for decision.

The present litigation, however, does not involve any purported interest payments that were made during the 1962–65 period. We are concerned only with the interest payments made subsequently, during the 1966–69 period, when the relationship between R. E. Lee and Western with

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[1] *Accord: Emmons* v. *Commissioner,* 31 T.C. 26 (1958), *aff'd,* 270 F. 2d 294 (3rd Cir. 1959), *cert. denied,* 364 U.S. 908 (1960); *Goldman* v. *United States,* 273 F. Supp. 137 (W.D. Okla. 1967), *aff'd,* 403 F. 2d 776 (10th Cir. 1968); *Golsen* v. *Commissioner,* 54 T.C. 742 (1970), *aff'd,* 445 F. 2d 985 (10th Cir. 1971).

respect to the Terry Lou Lee policies was different from what it had previously been.

On July 1, 1966, the prepaid premium fund relative to the six Terry Lou Lee policies was terminated, and the amount of the outstanding indebtedness owed by R. E. Lee to Western was reduced by the balance in the prepaid premium fund on June 30, 1966. Thereafter, there was no prepayment of premiums, and only the premiums currently due each year were paid as they became due.

R. E. Lee did not repay any part of the principal of the loans obtained from Western during the 1962–65 period; and the loans were carried on the books of Western and of R. E. Lee as an indebtedness owed by R. E. Lee to Western and bearing interest at the rate of 4 percent per annum.

What happened between R. E. Lee and Western with respect to the Terry Lou Lee policies each year during the period involved in the litigation (1966–69) can be illustrated by taking 1967 as an example.

As of July 1, 1967, the six Terry Lou Lee policies had developed additional cash surrender values totaling $19,583, and annual premiums totaling $17,826 became due on the six policies. In accordance with the customary procedure that had been worked out between R. E. Lee and Western, the following transactions took place as of July 1, 1967: (1) Western made what was designated as a new loan to R. E. Lee in the amount of $19,583, representing the then-current cash surrender values of the six Terry Lou Lee policies, and credited such amount to the account of R. E. Lee on its books; (2) Western charged $17,826, representing the annual premiums due on the six Terry Lou Lee policies as of July 1, 1967, against the account of R. E. Lee; (3) R. E. Lee remitted to Western a check in the amount of $4,337.52, representing the interest due on all the loans made by Western to R. E. Lee and secured by the six Terry Lou Lee policies; and (4) Western sent a check to R. E. Lee in the amount of $1,767.

In his income tax return for 1967, R. E. Lee claimed an interest deduction in the amount of $4,337.52 on the basis of the check in that amount previously mentioned as having been remitted to Western. This deduction was disallowed by the Internal Revenue Service; and such

disallowance formed part of the basis for a deficiency assessment which the IRS made against R. E. Lee, and which R. E. Lee paid, for the year 1967.

The statutory provision involved in this controversy is section 163(a) of the Internal Revenue Code of 1954 (26 U.S.C. § 163(a)), which provides that "There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness." The question to be resolved is whether, in substance as well as in form, the 1967 remittance in the amount of $4,337.52 from R. E. Lee to Western constituted an interest payment on indebtedness.

Essentially, the transactions of July 1, 1967, between R. E. Lee and Western with respect to the Terry Lou Lee policies were rather ordinary happenings of the sort that are very common in the life insurance business: *i.e.*, R. E. Lee borrowed from Western the full amount of the then-current cash surrender values of the six policies, used most of the proceeds of the loan to defray the then-due annual premiums on the six policies for the next 12 months, and took the remainder in cash to be used for other purposes; and R. E. Lee contemporaneously paid Western the amount of interest ($4,337.52) then due on all the loans which he had obtained through the years on the security of the Terry Lou Lee policies.

The $4,337.52 interest payment in 1967 related in part to the loans which R. E. Lee had obtained from Western on the Terry Lou Lee policies during the 1962–65 period, and in part to the loans obtained in 1966 and 1967. If the purported loan transactions during the 1962–65 period were shams (as the *Ballagh* decision of this court teaches) and interest payments made on such loans during the 1962–65 period would not have been deductible for income tax purposes, it seems to follow as a matter of simple logic that interest payments made after 1965 on the sham loans of 1962–65 could not be deducted for income tax purposes. This would make at least part of the $4,337.52 interest payment in 1967 nondeductible.

On the other hand, it is my opinion that the *Ballagh* decision does not require a rejection of the 1967 deduction claim insofar as it relates to the portion of the $4,337.52

interest payment which is allocable to the 1966 and 1967 loans on the Terry Lou Lee policies.

Although R. E. Lee was a wealthy man on paper, his estate was illiquid; and he had a serious cash-flow problem that made it impossible for him to pay the premiums on his insurance policies as they became due in 1966 and 1967 without borrowing the money from some source. In the absence of borrowing, he could not have maintained the extensive insurance coverage that he regarded as prudent and wise (and there is nothing in the record to indicate that his belief in the desirability of extensive coverage was unreasonable, under the circumstances). His credit was good with banks in Oklahoma City, and he could have borrowed from banks the amounts of money needed to pay the annual premiums on his Western policies (including the six Terry Lou Lee policies) as the premiums became due in 1966 and 1967. Interest payments on such loans from banks would, of course, have been deductible for income tax purposes under 26 U.S.C. § 163(a). However, R. E. Lee would have been required to pay much higher interest rates on loans from banks than the interest rate payable on loans that were readily available to R. E. Lee, in accordance with Oklahoma law, under the terms of the Western life insurance policies. Consequently, R. E. Lee borrowed from Western, rather than from banks, the money that he needed in order to pay the insurance premiums on the Western policies, including the six Terry Lou Lee policies, as the premiums became due in 1966 and 1967. Certainly, the mere source of a loan—whether from a bank or an insurance company—should not affect the deductibility for income tax purposes of interest paid on the loan.

It is my opinion, therefore, that the portion of the $4,337.52 interest payment in 1967 that covered the interest due on the 1966 and 1967 loans from Western under the Terry Lou Lee policies was deductible in accordance with 26 U.S.C. § 163(a).

What has been said with respect to R. E. Lee's interest payment of $4,337.52 in 1967 is also applicable to the other interest payments by the plaintiffs in 1966, 1967, 1968, and 1969 that are involved in the present litigation.

Syllabus

To summarize: the plaintiffs are entitled to recover with respect to interest payments made during 1966–69 on loans obtained from Western during the 1966–69 period, and are not entitled to recover insofar as interest payments on loans obtained during the 1962–65 period are concerned.

CONCLUSION OF LAW

Upon the trial judge's foregoing opinion and the findings of fact, which are adopted by the court, the court concludes as a matter of law that the plaintiffs are entitled to recover (together with interest as prescribed by statute) insofar as their claims are based upon interest that was paid on loans obtained from Western Security Life Insurance Company during the years 1966, 1967, 1968, and 1969, and judgment is entered to that effect. The amount of the plaintiffs' recovery in each case will be determined in subsequent proceedings under Rule 131(c).

The court further concludes as a matter of law that the plaintiffs are not entitled to recover insofar as their claims are based upon interest paid on loans obtained from Western Security Life Insurance Company during the years 1962, 1963, 1964, and 1965, and the respective petitions are dismissed as to such claims.

In accordance with the opinion of the court, a stipulation of the parties, and a memorandum report of the trial judge, it was ordered on June 2, 1978 that judgments be entered as follows:

M.S. Lee and Geraldine C. Lee	$28,038.73
R.E. Lee and Jane S. Lee	26,469.61

together with statutory interest.

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572 F.2d 826

JOSEPH AND HOLLY H. COORS v. THE UNITED STATES

[No. 73-75. Decided February 22, 1978]

ON THE PROOFS

Taxes; income tax; interest deductions; loans secured by insurance policies.—During 1955–1960 Joseph Coors purchased four adjustable whole life insurance policies on himself, his wife Holly being the registered owner and his family the ultimate beneficiary. The policies

Syllabus

permitted plaintiff Holly to make interest-bearing loans not exceeding 95% of the loan and cash surrender value of each policy, the interest becoming part of the indebtedness to the insurer against the policy. At no time during the life of the policies were the premiums prepaid or interest discounted. From 1959 and thereafter, due to financial difficulties, Holly borrowed money on the security of the policies within the said limitations, and paid the annual premiums, at the times material herein, using the loans, annual dividends and other cash. Plaintiffs, on their joint income tax returns for calendar years 1967 and 1968, claimed deductions for the interest paid to the insurer on the loans for those years. The Internal Revenue Service disallowed the deductions on the ground that they did not represent interest paid on a bona fide indebtedness and, absent timely action on the refund claims, plaintiffs filed the present suit seeking a tax refund, plus statutory interest, for 1967 and 1968. It is *held* that under the circumstances the interest payments involving insurance contracts issued prior to August 6, 1963 are allowable as deductions under Sec. 163(a) of the 1954 Code. There was substance and economic benefit associated with the loan transactions other than the generation of tax deductions. It is also *held* that the record does not support a conclusion that the payments were utilized to purchase, theoretically, 1-year renewable term insurance such that they should be considered personal and family expenses, and thus not deductible under Sec. 262 of the Code. Plaintiffs are entitled to recover, including statutory interest, and judgment is entered to that effect, with the amount of recovery to be determined pursuant to Rule 131(c).

Taxes; income tax; deductions; "interest on indebtedness".

[1] "Interest on indebtedness" as used in Sec. 163(a) of the 1954 Code means compensation for the use or forebearance of money.

Internal Revenue ⚖516.2

Taxes; income tax; deductions; interest on indebtedness; generally.

[2] If a transaction underscoring interest payments is considered to be a sham, the payments are not allowed as interest deductions for income tax purposes. Where the loan transaction manifests a purposive activity or where there was some substance to the transaction beyond the taxpayer's desire to secure the interest deduction, such a deduction is allowable.

Internal Revenue ⚖516.1

Taxes; income tax; deductions; interest on indebtedness; loans secured by insurance policies.

[3] Where the subject loans secured by pre-August 6, 1963 life insurance policies were obtained, because of financial difficulties, to meet currently due premium payments and were not specifically tailored for plaintiffs, the premiums were never prepaid or discounted, the interest was never prepaid, the transactions were not short termed, the loans were not contrived, ingenious or complex, and the insurance policies, despite the loans, had substantial net death benefits payable, plaintiffs were entitled to deduct for income tax purposes the interest payments

on the loans because, under the circumstances, the loans had substance and were of economic benefit.

Internal Revenue ⚖517

Insurance; life insurance; term insurance v. whole life insurance.

[4] Term insurance is significantly different than whole life insurance; the former insures against a contingency with benefits payable only if death occurs within the term, while whole life insurance insures against a certainty (death). The fact that because plaintiff systematically made loans on the security of the whole life insurance policies there was no significant build-up of the loan and cash surrender values of the policies, does not signify that the payments were utilized to purchase renewable 1-year term insurance.

Internal Revenue ⚖517

Taxes; income tax; deductions; interest on indebtedness; loans secured by insurance policies.

[5] Denial of an interest deduction should not be based on some esoteric concept derived from subtle and theoretic analysis.

Internal Revenue ⚖516.1

Gene W. Reardon, attorney of record, for plaintiffs. *Reardon, Reardon and Reardon,* of counsel

James L. Malone, III, with whom was *Assistant Attorney General M. Carr Ferguson,* for defendant. *Theodore D. Peyser* and *Donald H. Olson,* of counsel.

Before COWEN, *Senior Judge,* NICHOLS and BENNETT, *Judges.*

PER CURIAM: This case comes before the court on defendant's exceptions to the recommended decision of Trial Judge Thomas J. Lydon, filed February 10, 1977, pursuant to Rule 134(h), having been submitted on the briefs and oral argument of counsel. Upon consideration thereof, since the court agrees with the trial judge's recommended decision, as hereinafter set forth*, it hereby affirms and adopts the decision as the basis for the judgment in this case. It is, therefore, concluded that plaintiffs are entitled to recover, including appropriate interest as provided by law, and judgment is entered to that effect, with the amount of recovery to be determined pursuant to Rule 131(c).

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* Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed February 10, 1977, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

OPINION OF TRIAL JUDGE

LYDON, *Trial Judge:* In joint federal income tax returns, plaintiffs, husband and wife, claimed deductions in the amounts of $3,058 for the calendar year 1967 and $3,301 for the calendar year 1968 as interest payments made to the Equitable Life Insurance Society Of The United States (Equitable) during those years. Equitable had insured the life of plaintiff Joseph Coors (J. Coors) by means of four life insurance policies it issued during the period 1955—1960. Plaintiff Holly H. Coors (H. Coors) was the registered owner of these four policies and the family of J. Coors was the ultimate beneficiary of said policies. The Internal Revenue Service disallowed these claimed interest deductions on the ground said deductions did not represent interest paid on a bona fide indebtedness. As a result, tax deficiencies were assessed against plaintiffs for those years. Plaintiffs paid those tax deficiencies and thereafter filed timely claims for refund of the amounts so paid, plus interest. Plaintiffs' refund claims have not been acted on by the Commissioner of Internal Revenue. *See* 26 U.S.C. § 6532(a)(1). Since all procedural requirements have been met, plaintiffs' petition in this court for refund of federal income taxes, plus statutory interest, for calendar years 1967 and 1968, is timely and otherwise proper.

Plaintiffs maintain that the disputed payments to Equitable during 1967 and 1968 are properly deductible under section 163 (a) of the Internal Revenue Code of 1954, since these payments constituted "interest paid * * * within the taxable year on indebtedness" (26 U.S.C. § 163(a) (1970)). Defendant contends that the loan transactions which generated the interest payments in question were such that an indebtedness, within the intendment of section 163(a), did not exist in fact. Further, defendant argues that, on analysis, the claimed interest payments, in substance, represent the purchase of insurance protection during the years 1967 and 1968 and therefore should be considered "personal" and "family" expenses which are not deductible under section 262 of the Internal Revenue Code of 1954 (26 U.S.C. § 262). For reasons which follow, it is my

opinion that the payments in question are allowable as deductions under section 163(a).

I

In 1942, plaintiffs, married a year earlier, had their first child. In 1942 J. Coors began to purchase life insurance in order to provide protection and financial security for his family. J. Coors' first life insurance policy was a 20-Payment Life Policy with a face amount of $10,000 and annual premiums of $313.00. As his family grew, by 1954 plaintiffs had four children, J. Coors increased his life insurance coverage. In 1947 and 1948, J. Coors purchased two Ordinary Life Policies with face amounts of $30,000 (annual premiums of $712.00) and $10,000 (annual premiums of $261.00), respectively. In 1954, J. Coors purchased another Ordinary Life Policy with a face amount of $50,000 and annual premiums of $1,352.00.

As to the above four policies, J. Coors was the insured and owner of the policies, and H. Coors, his wife, was the beneficiary. Each policy was issued by Equitable, a mutual life insurance company, and each policy was arranged through Joseph Tooker (Tooker), an independent insurance agent, who was a friend, an ex-classmate, and brother-in-law of J. Coors. At all times material herein, Tooker served as the insurance adviser and agent for plaintiffs. Each of these policies contained a standard "Loans" provision which offered the insured the opportunity to borrow from Equitable on the security of and in accordance with the terms of the policy. J. Coors never borrowed from Equitable on the security of these four policies. These four policies are not directly involved in this litigation. However, they do serve to establish that plaintiffs, at an early stage in their married life, embarked on a purposive program of providing family protection and financial security by means of insurance coverage on the life of J. Coors.

By 1955, plaintiffs had five children. This situation induced J. Coors to purchase two more life insurance policies from Equitable in order to provide additional protection and financial security for his family, including the education of his five children. The policy purchased in

1955 had a face amount of $100,000, with annual premiums of $2,689. The policy purchased in 1959 had a face amount of $100,000, with annual premiums of $2,971. In 1960, the brother of J. Coors was kidnapped and murdered. This tragedy left the brother's widow with insufficient financial protection and security. It also convinced J. Coors he needed additional insurance coverage in order to protect and provide for his family's needs in case of his death. Accordingly, in 1960 he purchased two additional life insurance policies from Equitable. Each policy was in the face amount of $100,000, and each policy had annual premiums of $3,086. At this time J. Coors was 42 years of age.

The four life insurance policies purchased by J. Coors during the period 1955—1960 were Adjustable Whole Life Policies and were placed with Equitable through Tooker. Each of these policies was a typical, conventional, straight, ordinary life insurance policy offered by Equitable to the public at large.[1] The Adjustable Whole Life Policy was Equitable's most popular and largest selling life insurance plan. These four life insurance policies sowed the seeds for the instant litigation and are at issue herein.

As to these four Adjustable Whole Life Policies, J. Coors was the insured. However, H. Coors was the registered owner of these policies. While H. Coors was initially the designated beneficiary of each policy, an amendment to each policy in 1962 changed this designation so as to make a family trust the designated beneficiary of each policy.

Each of the above four policies contained a "Loans" provision which enabled the owner of the policies to obtain "an advance from the Society of a sum not exceeding such loan value on proper assignment of this policy and on the sole security hereof * * *."[2] Advances (or loans) were to

[1] The two 1960 policies contained option provisions (referred to as Plan B) which enabled the policy owner to utilize policy-generated dividends to purchase 1-year term insurance coverage equal to the stated loan and cash surrender value of each policy at the next policy anniversary date.

[2] While Equitable, like most insurance companies, did not look with favor on policy owners borrowing on the security of their policies, it could not refuse to allow such borrowing under the laws of the State of New York to which it was subject. Equitable, however, protected itself by limiting, as standard practice, the amount of borrowing against each policy to 95 percent of the appropriate loan and cash surrender value of each policy. The record suggests that a good many policy owners

bear interest at the rate of 5 percent per annum. Further, it was provided that "[i]nterest will accrue from day to day and will become a part of the indebtedness to the Society against this policy as it accrues." The policy owner could repay any indebtedness to Equitable at any time during the lifetime of the insured. Finally, each "Loans" provision stated: "Extended term insurance shall be without the right to loans."

The annual premiums associated with each policy remained constant throughout the life of each policy. These premiums reflected standard rates charged by Equitable relative to life insurance policies it sold to the public. At no time during the life of each of the four policies in issue were the premiums prepaid, nor were the premiums ever discounted in any way.

Dividends on the four policies in issue were available annually to H. Coors as the owner of said policies. Each policy provided that these dividends, at the option of the policy owner, could, *inter alia*, be paid in cash or applied toward the payment of any premium due on the policy.

H. Coors never borrowed from Equitable against the security of any policy she owned prior to 1959. In January of 1959, plaintiffs were "somewhat strapped for money." With the premium of $2,689 due to be paid on her 1955 policy on January 23, 1959, Tooker suggested that plaintiffs borrow the sum of $2,689 from Equitable against the security of said policy in order to pay said premium. The loan and cash surrender value of the policy at the time was in excess of $6,000. After the loan on this policy was consummated, which loan was used to pay the premium due on the policy, the loan and cash surrender value of the policy was $3,582. There is no evidence in the record that the subject of the tax deductibility, and its resulting impact on plaintiffs' financial situation, of the interest payments to be made to Equitable relative to said borrowings was ever discussed between Tooker and plaintiffs. Further,

borrow from Equitable on the security of their policies. Tooker testified he had some 50 to 60 clients who borrowed annually from Equitable on the security of their policies in order to pay, in whole or in part, the premiums due on their policies. The record also indicates that generally borrowing by policy owners from insurance companies increases when market interest rates are high because policy borrowing rates are lower.

there is no evidence that plaintiffs would not have borrowed from Equitable if they had known that interest payments on borrowings from Equitable would not be tax deductible.

In 1960, H. Coors began to borrow on the security of the 1959 policy in order to assist her in the payment of the premiums due on that policy. In 1961, H. Coors began to borrow on the security of the two 1960 policies in order to assist her in the payment of the premiums due on those policies. The findings of fact detail these borrowing transactions and will not be repeated here. It is sufficient to state that from 1961 and thereafter H. Coors continued to borrow on the security of the four policies in issue, within the limitations of the loan and cash surrender values of said policies as allowed by Equitable. In general, the annual premiums due on the four policies, at times material herein, were paid by a combination of the application of the loans received on each policy annually, application, in whole or in part, of the dividends received on each policy annually, and cash payments.[3]

The procedures generally followed relative to the loans obtained by H. Coors from Equitable were as follows: Each year, Equitable sent H. Coors a premium due notice for each policy. This notice would state the amount of premium payment due, the amount of dividends payable to H. Coors and the status of the loan balance account (*i.e.*, the total amount previously borrowed from Equitable). Upon receipt of this notice, H. Coors would contact Tooker, who, in turn would contact Equitable to determine what the loan and cash surrender value of the policy was in order to determine what the borrowing limits on the policy would be. Tooker would thereafter consider the amount of borrowing available for application toward payment of the premium. He would also give due regard to the application toward said payment of dividends then payable to H. Coors on the policy. This analysis would indicate the amount, if

[3] The record is less clear relative to the motivation behind H. Coors' borrowing in years subsequent to 1960. There is no evidence that plaintiffs' financial circumstances improved subsequent to 1960. An inference seems warranted that plaintiffs' financial circumstances continued to motivate the borrowings by H. Coors from Equitable in years subsequent to 1960, including the years 1967 and 1968.

any, of cash H. Coors would be required to pay in order that the total premium payment could be met. Tooker would obtain from Equitable a loan application form, labeled "Special Contract," and transmit the same to H. Coors for execution. H. Coors would execute the "Special Contract" and return it to Equitable, through Tooker, with the necessary cash payment which, together with the loan and dividend application, served to pay the premium due on the policy.

Each time a loan was sought from Equitable by a policy owner, a Special Contract had to be executed by the policy owner and Equitable. The provisions of the Special Contract, standardized in form and substance, used by Equitable had remained unchanged for some 25 to 30 years. The Standard Contract provided, *inter alia*, that "[t]he advance, with any interest due or accrued thereon, shall constitute an indebtedness to the Society [Equitable] against said policy," and that "[t]he advance with interest due or accrued may be repaid at any time during the lifetime of the insured * * *." The Standard Contract further provided that "[t]he Society may exercise all powers necessary, including the power to commute any amount payable in installments under said policy, to effect repayment of the indebtedness including interest due or accrued * * *." Under the Special Contract, the advance (loan) obligation was to be satisfied from the loan and cash surrender value of the policy if the policy were terminated or from death benefits payable if the insured died.

At times material herein, the loans obtained by H. Coors from Equitable never exceeded the loan and cash surrender values of the four policies in issue. Under the procedures followed by Equitable, there never would be any loans issued which would exceed these values. Accordingly, the loan obligations of H. Coors to Equitable were at all times secured by the cash reserve (cash surrender value) of each policy.[4] At no time did H. Coors prepay any interest obligations relative to loans obtained from Equitable. Finally, there is no dispute about the fact that the loans

[4] Because of this fact, a personal obligation of H. Coors to repay these loans never would surface.

obtained by H. Coors from Equitable were applied toward payment of the premiums due on the four policies in issue.

In 1967 and 1968, H. Coors made interest payments of $3,158.86 and $3,127.49, respectively, to Equitable on loan obligations due Equitable.[5] As a result of borrowing against the cash surrender values of the four policies in issue in succeeding years, there was no significant build-up of cash surrender values relative to each policy as of 1967. The loan balance account maintained by Equitable represented the total amount of borrowing over the years by H. Coors from Equitable and represented the amount due Equitable from H. Coors. The amount in the loan balance account served to decrease the net death benefits available on each policy should the insured die. If the amount of borrowing reflected in the loan balance account was paid by plaintiffs, the cash surrender value of each policy would be appropriately adjusted to reflect this fact and the net death benefits payable would be the face value of the policies ($100,000), or more in the case of the two 1960 policies to reflect Plan B Term Insurance coverage.[6] The following schedule reflects the status of the loan balance account, the net cash surrender value and the net death benefits payable at times material herein on the four policies in issue:

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[5] On their joint federal income tax returns, plaintiffs claimed deductions of $3,058 as interest payments for 1967 and $3,301 as interest payments for 1968. There is no explanation in the record as to the difference between the amounts of interest paid and the amounts of interest claimed as deductions by plaintiffs.

[6] It is noted that in 1960, H. Coors made cash payments of $998.46 (1955 policy) and $560.56 (1959 policy) to Equitable in order to reduce the loan indebtedness secured by said policies. These repayments suggest an economic reality to the loan transactions between H. Coors and Equitable at their inception since the repayments occurred long before the loan arrangement became a matter of controversy. *Compare Pierce* v. *Commissioner*, 311 F.2d 894, 896 (9th Cir. 1962).

[7] While the evidence is conflicting and confusing on the matter, the record preponderates in favor of a finding that the net cash surrender values set forth in this schedule do not include any prepaid premium amounts. [See p. 850]

[8] It should be noted that as to the last two policies, the net death benefits exceed the face amount of the policies ($100,000) because plaintiffs availed themselves of the Plan B Term Insurance option mentioned previously. [See p. 850]

	Loan Balance Account	Net Cash Surrender Value[7]	Net Death Benefit
Policy No. 14-865-650			
January 24, 1967	$22,083.23	$1,379.41	$ 77,916.77
January 29, 1968	24,111.53	1,347.05	75,888.47
Policy No. 59-202-296			
January 24, 1967	17,454.65	1,064.78	82,545.35
January 29, 1968	19,865.64	1,052.04	80,134.36
Policy No. 60-329-912			
June 2, 1967	15,716.28	993.18	100,783.72
May 24, 1968	18,032.49	1,081.93	100,867.51
Policy No. 60-329-913			
June 2, 1967	15,716.28	993.18	100,783.72
May 24, 1968	18,032.49	1,081.93	100,867.51[8]

II

Plaintiffs rest their claim for deductions of the interest payments made to Equitable in 1967 and 1968 on section 163(a) of the 1954 Code. That section provides:

(a) General Rule.

There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

The section speaks in broad language. It has been noted that the above provision does not contain any general requirement that interest payments, to be deductible, be ordinary, necessary, reasonable, or for a business purpose. In this regard, the deduction for interest differs from some other deductions allowed by the Internal Revenue Code. 4A Mertens, LAW OF FEDERAL INCOME TAXATION § 26.01 (1972).

There is no statutory[9] nor regulatory authority, and none is cited by defendant, that prohibits the interest

[Footnotes 7 and 8 appear on p. 849.]

[9] It is conceded that the provisions of 26 U.S.C. § 264 (1970), relating to the deductibility of amounts paid or accrued on indebtedness incurred or continued to purchase or carry a life insurance contract do not apply to the circumstances of this litigation. Section 264(a) (3) does speak to a situation like that presented by this case but the provisions thereof apply only to life insurance contracts purchased after August 6, 1963. All of the policies in issue were purchased prior to that date. See in this regard *Woodson-Tenent Laboratories, Inc.* v. *United States*, 454 F.2d 637, 638 n.2

deductions claimed by plaintiffs. Defendant does argue, *inter alia*, that the interest payments in question were, on its analysis, utilized to purchase, theoretically, 1-year renewable term insurance and thus were not interest payments in substance but merely payments made to purchase insurance protection. Viewed in this light, defendant maintains that the payments should be considered "personal" and "family" expenses and thus not deductible under 26 U.S.C. § 262 (1970). However, the record in this case will not support any such analytical and theoretical presentation. The interest payments made by H. Coors to Equitable had nothing to do with the costs of said policies, and, in fact, were not utilized in the payment of the premiums on said policies. The effort by defendant to convert the Adjustable Whole Life Policies into renewable 1-year term insurance policies is an unpersuasive exercise of theoretical mathematical argument which is devoid of meaningful factual substance. This matter will receive further discussion at a later point in this opinion.

The key words in section 163(a), *supra*, are "interest" and "indebtedness." In the absence of legislative definitions of these words, the courts have been required to address themselves to the meaning and intendment thereof in varying factual circumstances.

In *Old Colony R.R. Co.* v. *Commissioner*, 284 U.S. 552, 560–61 (1932), the Supreme Court discussed the word "interest" in the following manner:

> * * * And as respects "interest," the usual import of the term is the amount which one has contracted to pay for the use of borrowed money * * *.
>
> * * * * *
>
> In short, we think that in the common understanding "interest" means what is usually called interest by those who pay and those who receive the amount so denominated in bond and coupon, and that the words of the statute permit the deduction of that sum, and do not refer to some esoteric concept derived from subtle and theoretic analysis.

(6th Cir. 1972); *Golsen* v. *Commissioner*, 445 F.2d 985, 990 (10th Cir. 1971).

In *Deputy* v. *duPont*, 308 U.S. 488, 498 (1940), the Supreme Court, relying on the *Old Colony R.R. Co.* language, cited above, stated: "In the business world 'interest on indebtedness' means compensation for the use or forebearance of money. In the absence of clear evidence to the contrary, we assume that Congress has used these words in that sense * * *." Without more, it would not be unreasonable to consider the payments made by H. Coors to Equitable on the loans obtained from Equitable as interest payments.

However, while in form the payments may serve to compensate for the use of money, the transaction as a whole may be such as to negate any true indebtedness within the intendment of section 163(a). If a transaction underscoring interest payments is considered to be a sham, for example, said payments are not allowed as interest deductions *Knetsch* v. *United States*, 364 U.S. 361 (1960).[10]

The allowability of interest deductions in connection with loan transactions has been the subject of considerable litigation.[11] Both parties have cited in their briefs a number of cases which have dealt with the problem. Understandably, plaintiffs rely on cases in which the interest deductions on loan transactions have been allowed whereas defendant relies on cases in which interest deductions on loan transactions have not been allowed. On analysis of these cases it is apparent that the facts in each case were determinative of the result reached although in some instances similar factual situations gave rise to different results in different courts.[12] This much is true, no

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[10] One court, suggesting that it was not necessary to always first label a loan transaction a "sham" in order to deny a deduction for interest in connection with the loan, believed that an interest deduction was allowable where the loan transaction manifested a purposive activity or where there was some substance to the loan transaction beyond the taxpayer's desire to secure the interest deduction. *Goldstein* v. *Commissioner*, 364 F.2d 734, 738, 740–42 (2d Cir. 1966), *cert. denied*, 385 U.S. 1005 (1967). This seems to me to be a reasonable way in which to approach the question of the allowability of interest deductions in loan transaction situations.

[11] See 4A Mertens, LAW OF FEDERAL INCOME TAXATION § 26.13a (1972), for a short history of legislation dealing with the allowability of interest on insurance loan transactions. As indicated previously, there is no legislative prohibition against the allowability of the interest deductions claimed herein. What must be determined in this case is whether there is a judicially imposed prohibition against the allowability of the claimed interest deductions.

[12] *Compare Campbell* v. *Cen-Tex, Inc.*, 377 F.2d 688 (5th Cir. 1967) (relied on by plaintiff) and *Goldman* v. *United States*, 403 F.2d 776 (10th Cir. 1968) (relied on by

case has been cited by either party which involves a factual situation identical to the one presently under consideration. Analysis of past decisions in this area only confirms the fact that the allowability of interest deductions on loan transactions involving insurance contracts issued prior to August 6, 1963, varies in accordance with the different factual circumstances presented.

A general theme permeating the decisions relied on by the parties is that an interest deduction on a loan transaction will not be allowed where there was nothing of substance or economic benefit to be gained from the transaction other than an intended tax deduction. *See, e.g., Knetsch* v. *United States, supra,* 364 U.S. at 366; *Campbell* v. *Cen-Tex, Inc.,* 377 F.2d 688, 692 (5th Cir. 1967). In this case, it is concluded that there was substance and economic benefit associated with the loan transactions other than the generation of tax deductions.

The payment of the premiums due on the four policies in question gave H. Coors, as owner of the policies, life insurance protection on the life of J. Coors, her husband, to the extent that the face amount of the policies exceeded the loans outstanding relative to each policy.[13] This protection, substantial and of economic significance to H. Coors and her children, would continue as long as the policy premiums were paid when due. Thus, the payment of the premiums due on each policy inured to the benefit of plaintiffs, as did the policy loans obtained to pay part of those premiums. If plaintiffs wanted to continue this protection, it was necessary for them to obtain loans from Equitable to pay the balance of the premiums due and to pay the interest on said loans.

In *Kay* v. *Commissioner,* 44 T.C. 660, 672 (1965), the Tax Court made the following cogent statement which is applicable to the instant case:

* * * * *

defendant). See in this regard *Woodson-Tenent Laboratories, Inc.* v. *United States, supra,* 454 F.2d at 638–39.

[13] Each policy in issue would have paid over $75,000 if J. Coors had died in either 1967 or 1968. See the schedule on page 850, *supra.*

> The obligation on insurance policy loans is unique in that the insurance company looks to the cash surrender value of the policy to pay the loan and interest and no true personal liability arises against the borrower. However, we recognized in *J. Simpson Dean*, 35 T.C. 1083, that by making the loans the owner of the policy becomes obligated in a sense to pay interest thereon, and that such obligation is sufficient to qualify it as deductible interest for income tax purposes because such interest is in fact and in law a charge against his rights in the policies. * * *

Accord, Salley v. *Commissioner*, 55 T.C. 896, 903, *aff'd*, 464 F.2d 479 (5th Cir. 1972). *But see, Carpenter* v. *Commissioner*, 322 F.2d 733, 735–36 (3d Cir. 1963), and *Golsen* v. *Commissioner*, 445 F.2d 985 (10th Cir. 1971).

The loan transactions between Equitable and H. Coors were simple and straightforward. The form of each loan transaction reasonably reflected its substance. Each loan was the subject of a loan application contract between H. Coors and Equitable. These loan transactions were standardized as to form and procedure and were available to all Equitable policy owners. Indeed, under the laws of the State of New York, to which Equitable was subject, Equitable could not refuse to make loans to policy owners on the security of their policies. There is no basis, on this record, for viewing the loan transactions between H. Coors and Equitable as contrived, ingenious or complex.

It is true that each successive loan agreement served to reduce the cash surrender value of each policy. However, it also served to reduce the net death benefits payable under each policy to the extent of said loans. Thus plaintiffs' beneficial interests were affected by the loan transactions. These facts do not render the loan transactions "shams" or "without economic substance."[14] Moreover, as of 1967 and

[14] Defendant stresses the fact that the net cash surrender value of each policy was not significant in 1967 and 1968 because H. Coors systematically borrowed on the security of said policies from 1961 and thereafter. Defendant, however, ignores the concomitant decrease in the net death benefits payable, a viable economic consideration. While defendant is wont to dwell on the investment feature of the policies, *i.e.*, the cash surrender value build-up potential, it ignores the fact that plaintiffs were concerned about the protection feature of the policies when they purchased them and at all times while keeping the policies alive. There is no evidence in the record that plaintiffs purchased these policies for investment purposes. On the death of the insured, it is the net death benefits that are paid. The

1968, the net death benefits payable were considerably greater than the existing loans. *See Priester Machinery Co. v. United States*, 296 F. Supp. 604, 608 (W.D. Tenn. 1969). That the death benefits might become negligible if the present pattern of borrowing by H. Coors continued over a period of years is irrelevant under the circumstances. The immediate and substantial protection afforded by the policies in 1967 and 1968 was genuine and of economic substance. Plaintiffs might reasonably be most concerned about providing, to the extent financially possible, maximum insurance coverage during the years of their children's greatest dependence. They might otherwise provide for the family's financial security as family circumstances changed in the future. In any event, the use of borrowed funds to maintain life insurance coverage on the life of the family provider, J. Coors, has a significance far greater than the creation of tax deductions on the record in this case. The loan transactions in issue cannot be said to be illusory or purposeless.

It is also true that because of the opportunity to borrow on her policies, H. Coors' actual cash expenditure toward payment of her premiums on each policy was small in comparison to the amount of insurance coverage obtained.[15] Defendant considers this relatively small annual out-of-pocket cash expenditures made by H. Coors as a manifestation that the loan transaction lacked significant economic substance. Defendant, however, ignores the fact that with each loan, the net death benefits payable were reduced. It was the protection of the family in case of J. Coors' death that was the primary concern of plaintiffs. Borrowing on the policies was serving to reduce this protection. However, borrowing was necessary in order to meet the premium payments due without which there would be no financial security coverage. Thus, the cash

cash surrender value of each policy ceases to exist as an economic reality when death occurs whether such value is zero or $25,000.

[15] H. Coors made cash payments of $3,683 to Equitable in 1967, at which time the insurance protection provided by the four policies was around $360,001. In 1968, H. Coors made cash payments of $3,490 to Equitable at which time the insurance protection provided by the four policies was around $356,001. Dividends received by H. Coors in 1967 of $2,434, and in 1968 of $2,670 were applied, in whole or in part, toward premium payments.

payments, small as one might view them to be, were not trivial when the totality of the circumstances is taken into account.

Each of the cases primarily relied on by defendant in support of its contention that the payments in issue should be disallowed as interest deductions differs in significant respects from the case here under consideration.

In *Knetsch* v. *United States, supra,* Knetsch, a 60-year old taxpayer, purchased ten 30-year maturity single premium deferred annuity savings bonds from an insurance company for a price of $4,004,000. Knetsch entered into loan arrangements with the insurance company relative to the purchase of these bonds whereby, *inter alia,* he prepaid the interest due on said loans and also was allowed to borrow in excess of the cash and loan value provisions of the bonds. During the taxable years involved, Knetsch paid the insurance company $294,570 and received $203,000 back in the form of loans. Thus Knetsch's out-of-pocket expense was $91,570. Knetsch's loan arrangements were such that his borrowings kept the net cash value, on which any annuity payment (on maturity) or insurance payment (on death) would depend, at the "relative pittance of $1,000." The loan transactions which commenced in 1953 were terminated in 1956. At that time, the cash or loan value of the bonds was $1,000 greater than Knetsch's indebtedness to the insurance company. When Knetsch surrendered his bonds in 1956, his indebtedness to the insurance company was cancelled and he received the $1,000 in cash. In denying claimed interest deductions, the Supreme Court stated:

* * * * *

* * * For it is patent that there was nothing of substance to be realized by Knetsch from this transaction beyond a tax deduction. What he was ostensibly "lent" back was in reality only the rebate of a substantial part of the so-called "interest" payments. The $91,570 difference retained by the company was its fee for providing the facade of "loans" whereby the petitioners sought to reduce their 1953 and 1954 taxes in the total sum of $233,297.68. There may well be single-premium annuity arrangements with nontax substance which create an "indebtedness" for the purposes of § 23(b) of the 1939

> Code and § 163(a) of the 1954 Code. But this one is a sham. * * * [364 U.S. at 366.]

In this case, there was no "facade" of loans orchestrated for a single individual. The loan transactions between H. Coors and Equitable were straightforward, ordinary and available to any policy owner of Equitable. Moreover, the loan transactions here were not short termed and the interest on the loans were never prepaid. The cash payments H. Coors made to Equitable in 1967 and 1968 exceeded, even though minimally, the interest deductions claimed for those years, contrasting sharply with the significant spread in the *Knetsch* case between the cash paid and the excessively larger interest deductions claimed. Finally, in 1967 and 1968, the net death benefits payable on each of the four policies was in excess of $75,000, and totaled some $360,001 in 1967 and some $356,001 in 1968. These amounts can hardly be considered a "relative pittance." Since plaintiffs received insurance coverage of this magnitude during the years in issue, it is hard to accept defendant's repeated assertion that plaintiffs during those years received nothing of substance from the various policy advances or loans except a purported interest deduction. There is no basis for viewing plaintiffs' loan transactions with Equitable as "shams."

In *Ballagh* v. *United States*, 166 Ct. Cl. 191, 331 F.2d 874, *cert. denied*, 379 U.S. 887 (1964), this court was confronted with a *Knetsch* type situation wherein *Ballagh*, the taxpayer, purchased an annuity contract from a life insurance company and at the time of purchase paid the first year's annual premium of $10,000 (the contract provided for 41 annual $10,000 premium payments). On the same day, Ballagh borrowed an amount from a bank sufficient to prepay the 40 remaining annual premium payments, giving due consideration to the compound discount of 2.856 allowed by the insurance company when premiums were prepaid. Thereafter, Ballagh, the bank and the insurance company entered into a series of transactions, the bottom line of which showed Ballagh with a net profit of some $15,000 on the loan transaction which generated the 1953 and 1954 interest payments in question. The loan arrangement which underscored the borrow-

ing and interest payments in *Ballagh* commenced in December 1947 and was cancelled, at Ballagh's request, in December 1956, and the policy converted to paid-up insurance. Relying on *Knetsch*, this court found the loan arrangement to be a sham. The court stated in pertinent part:

> * * * For the transaction which we find to be a sham is not the initial insurance contract but the prepayment of all of the premiums and the loan agreement. We do not question that plaintiff's motive in buying the policy was a legitimate one. However, the subsequent prepayment of all premiums by borrowing from the insurance company itself was not necessary in so providing retirement income, and we find that such loan transaction did "not appreciably affect his beneficial interest except reduce his tax." * * * [166 Ct. Cl. at 198, 331 F.2d at 878.]

As indicated previously, there is no reasonable basis to consider the loan transactions in issue "shams." More importantly, as far as the *Ballagh* decision is concerned, is the fact that the premiums on the policies in question were never prepaid or discounted in any manner. H. Coors borrowed only to meet current premium payments due on the policies.

Golsen v. *Commissioner*, *supra*, involved special life insurance policies which at their inception contemplated loan transactions which embodied, *inter alia*, prepayment and discount of premiums and prepayment of interest. Indeed, the court referred to these transactions as "the super-structure of 'loans'." In addition, the annual premium payments were set at an artificially high level so as to create an abnormally high cash value immediately in order to facilitate the contemplated lending transaction. These arrangements allowed for borrowing from the insurance company the entire amount of the first year's cash values of the policies, which loans were simultaneously used to pay the greater part of the first year's premiums on said policies. This contrived arrangement led the court to declare the loan transactions a sham and without economic significance and substance. The loan transactions here in issue were not specially tailored for an individual; they were not contrived; the premiums were not manipulated to

facilitate borrowing on the policies; the premiums were never prepaid or discounted, nor was the interest ever prepaid. The *Golsen* facts are not present in this case. There are language and analysis in the *Golsen* decision which have surface application to the situation in this case. The *Golsen* decision stressed the fact of "systematic borrowing," and the fact the policies had no cash surrender value because of the borrowings. Further, the *Golsen* decision relied on an analysis which led the court to view the policies as renewable term insurance policies and thus enabled the court, utilizing hypothetical average term insurance premium rates, to conclude that the interest deductions claimed were equivalent to renewable term insurance rates and thus represented actuarially the sums necessary to support insurance benefits available under policies which had no cash surrender value. This analysis led the court in *Golsen* to find that since the interest deductions claimed in fact represented the cost to the taxpayer of the insurance benefits provided, no interest deduction was allowable. Defendant stresses these aspects of *Golsen* in urging this court to reject the interest deductions claimed by plaintiffs. However, my reading of *Golsen* indicates that the sham nature of the loan transactions at the inception was the crucial factor underscoring that decision and the court's language and analysis must be read in that light.[16] In any event, the *Golsen* holding has not been universally adopted as acceptable precedent. *See Woodson-Tenent Laboratories, Inc.* v. *United States*, 454 F.2d 637, 638–39; *see also Campbell* v. *Cen-Tex, Inc.*, *supra*; *cf. Goldman* v. *United States*, 403 F.2d 776 (10th Cir. 1968).

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[16] In *Golsen*, the court noted it needed expert actuarial assistance in its consideration of the matter before it. It relied on the testimony of such an expert who analyzed the matter, utilizing the renewable term insurance approach, and showed to the court's satisfaction that the loan arrangement had no essential relationship to the insurance benefits provided. In this case, defendant produced a senior actuarial employee of the Internal Revenue Service who failed to persuade that the loan transactions in issue were without any substance or bore no relationship to the insurance benefits provided. As in *Golsen*, defendant's analysis in this case rested on the premise the policies in issue were in substance renewable 1-year term insurance policies.

Analysis of the other cases cited by defendant also shows marked and significant factual differences from the case at bar which thereby serve to eliminate their precedential value. For example, in *Goldman* v. *United States, supra,* the denial of interest deductions on life insurance policy loans was mandated by a finding that the loan transaction was without economic substance. The offensive feature of the loan transaction in *Goldman* was the prepayment and discounting of premiums. Further, it was observed that while the interest on the loans was 4 percent, the annual increase in policy value was at the rate of 3 percent, an annual loss of 1 percent. The court in *Goldman* noted that the annual loss of 1 percent indicated a lack of economic substance to the loan transactions since the record in the case revealed that the taxpayer was not pressed for cash. As indicated previously, the premium payments in this case were never prepaid or discounted. Further, the record here suggests a cash liquidity problem relative to the continued borrowing by H. Coors. As observed previously, the allowability of interest deductions on insurance policy loans has been litigated in a wide variety of factual settings. One can find in the litigated decisions which have denied interest deductions some features of the loan transactions between H. Coors and Equitable. Conversely, one can also find those same features in decisions which have upheld the interest deductions. As noted in *Rothschild* v. *United States,* 186 Ct. Cl. 709, 717, 407 F.2d 404, 408 (1969), the cases dealing with interest deductions generated by loan transactions lack uniformity, are seemingly conflicting and are productive of confusion. The common denominator to be found in those cases denying the interest deduction is the conclusion that the loan transaction could not appreciably affect the taxpayer's beneficial interest except to reduce the taxpayer's federal income tax.

Recognizing this common denominator, defendant made a concerted effort to show that although the policies in question were, in name, provisions and administration, Adjustable Whole Life policies, they functioned, on its analysis, like renewable 1-year term insurance policies. Viewing the policies as guaranteed renewable 1-year term

insurance policies, defendant utilized an average hypothetical 1-year renewable term insurance premium rate,[17] and, giving consideration to the insurance coverage provided by the four policies in issue in 1967 and 1968, computed the 1-year term insurance cost for said policies. Since this cost figure was somewhat equivalent to the interest deductions claimed by plaintiffs in 1967 and 1968, defendant concludes the interest deductions claimed were actually payments for insurance protection during those years.

I have carefully considered the testimony of the government's expert witness who prepared the detailed schedules which provided the foundation for defendant's argument that the policies in question should be treated as guaranteed renewable 1-year term insurance policies. On the record of this case, I am not persuaded that this analysis presents a sufficiently realistic basis, actuarial or otherwise, for impugning the loan transactions in question.

Furthermore, defendant's guaranteed renewable 1-year term insurance approach is in substance a hypothetical analysis. The record indicates J. Coors, in all probability, would not be able to obtain term insurance coverage in 1967 or 1968. Further, if the policies are viewed as term insurance policies, it is doubtful if any loans could be obtained on the security thereof from Equitable since term insurance policies generally do not have any reserve values (see the "Loans" provision clause of the policies, *ante* at 845–46). It is recognized that term insurance is significantly different than whole life insurance. Term insurance insures against a contingency (death during the term), while whole life insurance insures against a certainty (death). One cannot hypothesize about term insurance because the provisions of any such policy determine whether renewability will be guaranteed, whether a physical examination will be required, etc. *See generally* Huebner S. S. and Black K., *Life Insurance* at p. 75 (8th ed. 1972). These are realistic observations and they serve to discredit the hypothetical analysis advanced by defendant.

[17] In this endeavor, defendant relied on an Internal Revenue Service published schedule (PS–58) of average term insurance rates utilized by the Service in evaluating employee pension plans, etc. The guaranteed renewable 1-year term insurance rate that Equitable generally charged was not in the record.

As the Supreme Court observed in *Old Colony R.R. Co.* v. *Commissioner, supra,* the denial of an interest deduction should not be based on "some esoteric concept derived from subtle and theoretic analysis." (284 U.S. at 561).[18]

Finally, defendant has advanced this renewable 1-year term insurance analysis approach in opposing interest deductions on policy loans in several other cases. In rejecting this analysis in *Campbell* v. *Cen-Tex, Inc., supra,* the Fifth Circuit observed:

> Perhaps the Government has a broader definition of term insurance than is generally used. A term policy of life insurance is one which is issued for a limited and specified period with benefits payable only if death occurs within the period. Term policies do not, generally, have reserve values.

Accord, Priester Machinery Co. v. *United States, supra,* 296 F. Supp. at 609–10. As indicated earlier, however, the expert witness in *Golsen* v. *Commissioner, supra,* satisfied the Tenth Circuit that this type of analysis had meaningful implications under the circumstances of that case. I am not persuaded in this case that the analysis proffered by defendant whereby it treats these policies, which in all material respects are Adjustable Whole Life policies, as 1-year guaranteed renewable policies, is meaningful enough to justify denial of the interest deductions claimed.

The one unvarnished factor in this case on which defendant's opposition to the claimed interest deductions can objectively rest is this: the systematic borrowing by H. Coors on the security of the four policies in order to assist her in the payment of the annual premiums due thereon was such that in 1967 and 1968, the tax years in issue, there was no significant build-up of the loan and cash surrender values of said policies. However, defendant has

[18] The tenuous nature of defendant's litigating analysis position is to be found in defendant's response to the question of what would have happened if the taxpayer repaid all the loans thereby maximizing the loan and cash surrender values of each policy. Defendant advised that it would then characterize the policies as guaranteed renewable 1-year term insurance policies with a retro-conversion feature, *i.e.*, by repaying the loans, the policies would be once again Adjustable Whole Life policies. Defendant cites no policy provisions which provide for any such changes in the character of each policy, nor is the record in this case enlightening relative to defendant's blithe use of retro-conversion as a concept to prevent the total collapse of its hypothetical analysis.

cited no case where, on this factor alone, an interest deduction based on policy loans has been disallowed. Further, the insurance policies issued to H. Coors were standard policies, available to the public at large, and the loan transactions were straightforward and simple. The death benefits payable, if J. Coors had died in 1967 or 1968, were substantial and greatly exceeded the maximum indebtedness then outstanding. The borrowing by H. Coors was purposive and reasonable under the circumstances of this case.

In all the cited cases where an interest deduction on policy loans has been denied, other significant factors have served to contaminate the loan transaction and resulting claimed interest deduction. These factors, missing in the instant case, are prepayment and/or discounting of premium payments, setting premium payments at an artificially high level in order to facilitate immediate and significant borrowing, prepayment of interest, and contrived, ingenious, and complex loan arrangements whose only ultimate and/or realistic purpose was to secure intended tax deduction benefits. In *Goldman* v. *United States, supra,* 403 F.2d at 778, the Tenth Circuit observed that the principles utilized by the courts in restricting the deductibility of interest in various circumstances were generally of the "'smell-test' variety." I am unable to detect in the loan transactions between H. Coors and Equitable an "odor piscatorial." *See Alinco Life Ins. Co.* v. *United States,* 178 Ct. Cl. 813, 823, 373 F.2d 336, 341 (1967).

CONCLUSION OF LAW

Upon the opinion and the findings of fact which are made a part of the judgment herein, the court concludes as a matter of law that plaintiffs are entitled to recover, including appropriate interest as provided by law, and judgment is entered to that effect, with the determination of the exact amount of recovery to be made in further proceedings under Rule 131(c).

ALASKA NATIVE CLAIMS SETTLEMENT ACT

Stanley J. McCutcheon, Clifford J. Groh, Ronald G. Benkert and William A. Greene — Docket No. F–8

ATTORNEY EXPENSE CLAIM

Upon consideration of the trial commissioner's opinion in Docket No. F–8, not based on evidence adduced under oath and subject to the test of cross-examination or rebuttal, since there were no adversary hearings, and based on a record consisting substantially of claimants' submissions, a report of the court's auditor, his work papers and his memorandum to the trial commissioner, the Review Panel on December 30, 1977 filed its opinion respecting the claim of the Estate of Stanley J. McCutcheon, Clifford J. Groh, Ronald G. Benkert and William A. Greene for attorney out-of-pocket expenses incurred incident to performance of legal services in connection with the preparation of the Alaska Native Claims Settlement Act, Sec. 20, Pub. L. 92–203, 85 Stat. 688, from 1966 through December 18, 1971. The Review Panel affirmed the trial Commissioner's allowance of $23,325.68 to claimants on the basis of the concession of that amount by the representative of the Attorney General, the failure of other potential adverse parties to participate in the proceedings or to contest the amounts at issue, and the absence of affirmative evidence in the record that reimbursement for any of the items finally allowed would offend the statutory criteria governing the same.

ORDERS

No. 3-75. SEPTEMBER 29, 1977

Fred L. Riggleman and
Sherri L. Riggleman

Eminent domain; temporary taking; impoundment of personal property; compensation for use of real property; implied contract; assignment of claim; Government equipment on premises.—On September 29, 1977 the court entered the following order:

Richard W. Cardot, attorney of record, for plaintiffs. *Cardot, Kent & Queen,* of counsel.

Julie P. Dubick, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"This case is before the court on defendant's motion for summary judgment. The plaintiffs, Fred L. Riggleman and Sherri L. Riggleman, husband and wife, seek compensation from the defendant for the use of their farm real estate; the defendant in early 1967 impounded a number of items of personal property in connection with certain criminal cases, and the items have remained impounded on the farm property since that time. On the basis of the pleadings, briefs, and other materials submitted by the parties, without benefit of oral argument, we grant defendant's motion.

"The facts may be stated briefly. On February 10 and 11, 1967, a number of search warrants were issued authorizing searches for stolen government property in various locations in and around Beverly, West Virginia. The farm property was owned at the time of the search by Woodrow and Wanda Yokum, the parents of Sherri L. Riggleman. Seizure notices were placed on a barn located on the property, and it was padlocked. Although the defendant removed some property from the premises, it left several military trailers, various motorized vehicles, portable electrical generating equipment, three Army Signal Corps Transmitting Shelters, and other equipment with seizure notices on the premises outside the barn. The equipment had been placed on the farm by Woodrow Yokum and his agents.

"On August 5, 1968, Woodrow Yokum was convicted on six counts of violation of 18 U.S.C. § 2312 (1970) (interstate transportation of stolen motor vehicle), one count of violation of 18 U.S.C. § 2314 (1970) (transportation of stolen property in interstate commerce), and three counts of violation of 18 U.S.C. § 641 (1970) (unlawful sale of government property). On appeal, the conviction on one count of unlawful sale of government property was reversed; the evidence showed that Yokum had apparently stolen the truck in question from the West Virginia State Road Commission, of which he was Highway Supervisor, rather than from the United States. *United States v. Yokum*, 417 F.2d 253, 255 (4th Cir. 1969), *cert. denied*, 397 U.S. 907 (1970).

"The farm, subject to a life estate retained by Wanda Yokum, was transferred to Sherri L. Riggleman by a deed dated December 23, 1968. On July 9, 1970 a 31-count indictment against Woodrow Yokum was dismissed by the United States District Court for the Eastern District of Virginia. Woodrow and Wanda Yokum demanded the return of all the personal property except that mentioned in the first indictment along with compensation for the use of the farm property and for deterioration and loss of use of the personal property that had been impounded. The government was willing to return those items to which he could establish his rights of ownership. Yokum was unable

to do this to the Government's satisfaction, and negotiations broke down. On May 22, 1972, the defendant requested permission to remove the property from the premises, which was denied. On April 19, 1973, Wanda Yokum released her life estate to Sherri L. Riggleman. On March 26, 1975, the defendant again requested permission to remove the property from the farm, but it was denied.

"The plaintiffs filed suit in this court on January 2, 1975, seeking compensation for the use of their real property from February 10, 1967, and an order to remove the personal property in question from their real estate.[1]

"The plaintiffs seek a trial to determine whether the defendant's actions in impounding the personal property on the farm were 'reasonable' and fell within the doctrine of *in custodia legis* or were unreasonable and constituted a taking under the Fifth Amendment. However, there is no need to hold a trial to decide this issue.

"As the holder of a remainder interest, Sherri L. Riggleman was not entitled to any compensation for the use of the farm before the release of the life estate.[2] A life tenant has complete rights to the present enjoyment of land. *Kanawha Banking & Trust Co. v. Alderson*, 129 W. Va. 510, 40 S.E.2d 881, 885 (1946); *Koen v. Bartlett*, 41 W. Va. 559, 23 S.E. 664, 666 (1895). As life tenant, Wanda Yokum would have been entitled to all rents from the property arising under any implied-in-fact-contract. *McDonald v. Jarvis*, 64 W. Va. 62, 60 S.E. 990, 992 (1908); *Koen v. Bartlett, supra.* A remainderman has no interest in rents during the existence of the life estate. *Koen v. Bartlett, supra;* 51 Am. Jur. 2d *Life Tenants and Remainderman* § 130 (1970).

"Similarly, the measure of damages for a temporary taking as in the instant case[3] would be compensation for

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[1] Woodrow Yokum also filed a suit in this court on January 2, 1975, for the reasonable value of the personal property impounded on the farm. The case was dismissed on the ground that the claim was barred by the statute of limitations, 28 U.S.C. § 2501 (1970). *Yokum v. United States*, 208 Ct. Cl. 972, 529 F.2d 532 (1975), *cert. denied*, 429 U.S. 820 (1976).

[2] Given the disposition of the case, there is no need to determine the standing to sue of the plaintiff Fred L. Riggleman, who apparently has no recorded interest in the farm property.

[3] The defendant argues that, if there was a compensable taking of the real estate, it was temporary. This is supported by the fact that the defendant has sought to

the use of the property, to which the life tenant would be entitled, the loss of improvements, and the cost of restoring the property to its pretaking condition. *United States v. Pewee Coal Co.*, 341 U.S. 114, 117 (1951); *Eyherabide v. United States*, 170 Ct. Cl. 598, 607, 345 F.2d 565 (1965). There is no allegation of any waste or damage to the property such as to entitle a remainderman to compensation therefor; an individual is entitled to compensation for a taking only to the extent his interest is damaged. *See United State v. Dickinson*, 331 U.S. 745, 748 (1947); *Alexander v. United States*, 39 Ct. Cl. 383, 394 (1904); 2 NICHOLS ON EMINENT DOMAIN §§ 5.22[1]–5.22[2] (revised 3d ed. 1976).

"Although the Yokums executed an assignment of any claims they might have with respect to the use of the farm property to the plaintiffs on June 2, 1976, such an assignment of claims against the United States is ineffective. 31 U.S.C. § 203 (1970). Also, the West Virginia statutes cited by plaintiff do not upon transfer of the land assign causes of action that may have accrued to the transferor in connection with the land to the successor in interest; they merely allow the successor in interest to have the same rights and remedies against a tenant for a breach of a lease agreement that the predecessor in interest would have had. Therefore, there is no question of a transfer of the causes of action by operation of law such as arguably might not fall within the purview of 31 U.S.C. § 203 (1970). *See Keydata Corp. v. United States*, 205 Ct. Cl. 467, 504 F.2d 1115 (1974). As a result, the plaintiffs can recover on no cause of action that may have arisen before the release of the life estate.

"The plaintiffs likewise are entitled to no compensation for the use of the property after the release of the life estate. Both before and after the release, the defendant sought permission to remove the property from the farm. Under these circumstances there can be no implied-in-fact contract. For such a contract to exist, mutual assent is necessary. *Russell Corp. v. United States*, 210 Ct. Cl. 596, 537 F.2d 474, 482 (1976), *cert. denied*, 429 U.S. 1073 (1977);

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remove the personal property since 1972.

Operational Manuals, Inc. v. United States, 205 Ct. Cl. 854, 855 (1974). Since the Government never acceded to any requests for rent and wished since 1972 to remove the property, the requisite mutual assent was lacking.[4]

"Neither do plaintiffs have a valid taking claim for the period since the release of the life estate. Before the release of the life estate, the defendant, as plaintiffs knew, asked permission to remove the equipment from the farm; this request was repeated subsequently. The plaintiffs are estopped from asserting that the defendant has taken their property by storing the equipment thereon, when they have refused to allow the Government to remove it. *Emeco Industries, Inc. v. United States*, 202 Ct. Cl. 1006, 1015, 485 F.2d 652, 657 (1973); *United States v. Georgia-Pacific Co.*, 421 F.2d 92, 96 (9th Cir. 1970). They are in effect acting as volunteers in Sherri's father's dispute with the defendant over the equipment, in which present plaintiffs claim no interest themselves. Under the facts, the impoundment interferes only with the use of the equipment; any interference with the use of the farm now arises only from plaintiffs' refusal to allow the defendant to remove the personal property. There is no reason why the defendant should be charged rent for its storage on Sherri's farm, when it is willing to store it elsewhere pending a resolution of the dispute.[5]

"The plaintiffs assert that under state law they have a lien for the accrued rent; however, a lien may not be asserted against the Government's property without its consent.[6] *Armstrong v. United States*, 364 U.S. 40, 46 (1960); *United States v. Munsey Trust Co.*, 332 U.S. 234, 241 (1947). In *Algonac Mfg. Co. v. United States, supra*, 192 Ct. Cl. at

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[4] *Cf. Algonac Mfg. Co. v. United States*, 192 Ct. Cl. 649, 428 F.2d 1241 (1970) (implied-in-fact contract held to exist, but plaintiff had no right to storage charges for the period following the Government's request for permission to remove the property from the premises).

[5] According to an affidavit of a United States Attorney, who handled the criminal proceedings, the Government took the position that the property belonged to the United States. *Yokum v. United States, supra*, 208 Ct. Cl. at 974.

[6] The question of ownership of the personal property is not now before the court. Yokum's suit for the taking of the property was dismissed. *Supra* note 1. Even if the property does belong to Woodrow Yokum, it would be impermissible for plaintiffs to charge the defendant rent for its storage since the Government is being forced by plaintiffs to store it there.

677, 428 F.2d at 1257, the court held that rent did not accrue while plaintiff held the Government's property as security for the accrued rent against the wishes of the Government.

"IT IS THEREFORE ORDERED AND CONCLUDED that defendant's motion for summary judgment is granted and that plaintiffs' petition is dismissed.[7]"

Plaintiffs' motion to set aside the foregoing order was denied on November 25, 1977.

No. 373–75. SEPTEMBER 29, 1977

Hale Bros. Associates, Inc.

Pleading and practice; patents; discovery; production of documents; pleading of third party; subpoena duces tecum; reference of procedural motions.—On September 29, 1977 the court entered the following order:

Elliott I. Pollock, attorney of record, for plaintiff.

Robert H. Plotkin, with whom was *Assistant Attorney General Barbara A. Babcock,* for defendant.

Allen Kirkpatrick, attorney of record, for third-party defendants.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"In this patent case, plaintiff seeks leave to file a reply brief and seeks review under Rule 53(c)(2)(ii) of a trial judge's procedural order. Some discussion of the involved factual background is necessary to resolution of the pending motion.

"The trial judge's order which sparks this controversy granted the Rule 74 motion of certain third-party defend-

[7] However, in the event that the Government should fail to remove the personal property from the farm in a reasonable time after the plaintiffs grant it permission to enter upon the land for such purpose, the plaintiffs may seek leave of court to amend their petition in accordance with Rule 39 to state any cause of action that may accrue from a refusal of the Government to remove the property after permission is granted. Since the defendant has been seeking to remove the property in question since 1972, there seems to be no need at this juncture to issue an order to the defendant to remove it, as requested in plaintiffs' petition, even assuming that this court could issue such an order in this case.

ants (TPDs) to compel the production of documents. The motion sought access to documents in the possession of Dr. Gerhard Dirks. Dr. Dirks was the inventor of devices whose patents are in issue here, but the patents are now owned solely by plaintiff. Dr. Dirks does not work for plaintiff and plaintiff avers that Dr. Dirks 'has no contractual obligation to Plaintiff to participate or cooperate in this litigation.' Dr. Dirks is not a party to the suit.

"Earlier, Dr. Dirks had been deposed, pursuant to a subpoena issued July 27, 1976. The subpoena included an order that Dr. Dirks bring with him all materials bearing in any way on the patents in question. Some were furnished, although no documents were supplied bearing on the so-called '007 patent. At the deposition, TPDs told Dr. Dirks that if they wanted any additional materials, they would so inform him. They did not do so, but instead they filed a motion (on October 15, 1976) to compel production of documents in the possession of plaintiff. On November 5, 1976, the motion was allowed and was affirmed by the court on January 27, 1977. Plaintiff supplied those documents in its possession, indicating, however, that other documents were in the sole possession of Dr. Dirks. By motion of April 4, 1977, the TPDs again moved for an order for the production of certain documents, the motion noting that the documents sought were in the possession of Dr. Dirks. On May 16, 1977, the trial judge allowed the motion, noting on the face of the motion, 'Documents fall within scope of subpoena duces tecum served July 27, 1976, and law of the case per order of Trial Judge filed November 5, 1976, affirmed by Court January 27, 1977.' On May 24, 1977, plaintiff filed a request for 'reconsideration, vacating and/or clarification' of the May 16 order, emphasizing that the documents were in the sole possession of Dr. Dirks and that Rule 74 does not authorize an order to a nonparty to produce documents. The trial judge responded:

> DENIED JUN 10 1977, except that the order entered on May 16, 1977 is clarified to the extent that it contemplates compliance by Gerhard Dirks with the subpoena duces tecum to which he was and still is subject in this case, there being a sufficient showing

> that the evidence sought may lead to discovery of admissible evidence on the issue of fraud in procurement of the '007 patent.

"Next, Dr. Dirks moved for a protective order under Rule 71(f), contending that the documents sought were protected by the attorney-client privilege. This June 16 request was denied on July 22, 1977, 'for failure to identify in sufficient detail documents as to which attorney-client privilege is claimed.' Meanwhile, on June 22, 1977, the trial judge issued a 'NOTICE TO GERHARD H. DIRKS TO APPEAR AS THIRD-PARTY PLAINTIFF,' stating:

> Since it appears that the validity of United States Patent 3,228,007 has been placed in issue, and Dirks, the purported inventor of the invention disclosed and claimed therein, has in his possession documentation which could, possibly, lead to the discovery of admissible evidence relating to the issue of the validity of the patent in suit, Dirks is a proper party to be joined in this action as a third-party plaintiff.

Pursuant to this order, Dr. Dirks was served with the notice on July 13, 1977. The time allowed for his response has expired. Rule 41(g).

"Against this setting, we next consider plaintiff's claim that the order of May 16, 1977, and the clarifying order of June 10, 1977, should be vacated. Rule 53 permits a party dissatisfied with a trial judge's procedural order to request the court to review the order 'upon a showing of extraordinary circumstances whereby further proceedings pursuant to the said order would irreparably injure the complaining party or occasion a manifest waste of the resources of the court or of the parties.' Rule 53(c)(2)(ii). Neither injury nor manifest waste has been shown.

"Surely plaintiff cannot contend that Hale Bros. Associates is irreparably injured by an order which contemplates compliance by Dr. Dirks, not Hale Bros. It is true that the motion leading to the rule of May 16 was based on Rule 74, which plaintiff correctly observes is applicable only to parties. Dr. Dirks is not a party. But the trial judge's notation on the moving papers and his June 10 clarification make clear that the source of authority to order Dirks to disclose his documents was the subpoena duces tecum,

Rule 82(b), which can properly be used against a *non*party. Rule 81(b). Accordingly, no irreparable injury has been shown to fall upon plaintiff, which is unaffected by the order compelling disclosure of Dr. Dirks' patent library.

"Likewise, we find no basis for concluding that any waste of plaintiff's resources will occur as a result of the trial judge's order. Third-party defendants are bearing the costs of the efforts of Dr. Dirks and his attorney in reviewing the patent files. No expenditure, wasteful or otherwise, of plaintiff's resources is occasioned by the complained-of order. Thus, no waste of plaintiff's resources can be invoked to justify upsetting the orders on review.

"The court's resources, too, are not squandered by the trial judge's ruling. Indeed, such waste would more likely be precipitated by vacating the trial judge's ruling and forcing third-party defendants to begin again with a new subpoena duces tecum. As things now stand, the continued compliance by Dr. Dirks with the trial judge's order can only facilitate the prompt resolution of issues before the trial judge.

"Our ruling that plaintiff has not met the standards of Rule 53 does not imply our wholehearted agreement with the means by which the trial judge has ordered this disclosure. It would have been better if the order had not originally been predicated on a motion to produce documents or had flowed more promptly from Dr. Dirks' noncompliance with the broad scope of the subpoena duces tecum. But we note that Dr. Dirks is now reviewing his files, at third-party defendants' expense, and there appears to be no reason to impede the progress now being made, especially since the documents could properly be subject to a new subpoena duces tecum.

"Although plaintiff, not Dr. Dirks, has brought this motion before us, we observe that he retains his freedom to reassert his attorney-client privilege once the documents have been reviewed sufficiently that such claims can be made with specificity. Contrary to the contention of third-party defendants, the trial judge has not ruled that Dr. Dirks has no privilege in these documents, but rather has rejected any claim of privilege not made with specificity. His ruling that Hale Bros. had no privilege in the

documents does not preclude Dirks from raising that privilege in an appropriate manner.

"IT IS THEREFORE ORDERED that plaintiff's unopposed motion for leave to file a reply to opposition by certain third-party defendants to plaintiff's request for review under Rule 53(c) (2)(ii) is granted.

"IT IS FURTHER ORDERED, upon consideration of the briefs of the parties and plaintiff's reply brief, without oral argument, that plaintiff's motion for review of the trial judge's orders of May 16 and June 10, 1977, is granted but the relief requested by plaintiff is denied, and the case is remanded to the trial judge for further proceedings."

No. 349-76. SEPTEMBER 29, 1977

Steven Craig Harwell

Civilian pay; postal service one-year student appointment; "public policy" program; failure to secure career position.—On September 29, 1977 the court entered the following order:

David T. Lopez, attorney of record for plaintiff. *David T. Lopez & Assoc.*, of counsel.

R.W. Koskinen, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

"This case is before the court, without oral argument, on defendant's motion for summary judgment. Plaintiff has not responded to this motion. Upon review of the parties' submissions, we hold that defendant is entitled to judgment as a matter of law.

"In March 1973, plaintiff was given a one-year appointment as a part-time postal assistant under a special United States Postal Service 'public policy' program for students between 16 and 22 years old in need of financial assistance to continue their education. At the end of his one-year term, plaintiff requested consideration for a Postal Service career position. As a special 'public policy' employee, plaintiff was permitted to apply for a regular full-time

position after satisfactory completion of his one-year term but his appointment was not automatic and he had to meet regular career employee standards.[1] Upon examination, the Postal Service found that plaintiff did not meet the physical requirements for a full-time job[2] and as a result he was denied a transfer to a career position. Plaintiff was then separated from the Postal Service when his limited special appointment expired.

"Plaintiff alleges that he was terminated in an arbitrary, capricious and illegal manner and was improperly denied an appeal under adverse action procedures or the union grievance procedure. We believe, however, that plaintiff's separation was lawful and in line with Postal Service procedure and his rights as a 'public policy' employee. Plaintiff was separated from the Postal Service because his one-year appointment expired and not, as he alleges, because of his physical disability. His termination was not an adverse action but merely part of the original conditions of his appointment. *See,* Civil Service Commission Federal Personnel Manual, Supplement 752–1, § S1–16(3). Plaintiff did not hold a full-time career position at the time of his separation and therefore did not have appeal rights under the Postal Service unions' grievance procedure available only to members of the bargaining unit and not to 'public policy' employees. As for the refusal to take him on as a full-time employee, plaintiff, who did not respond to the Government's motion for summary judgment, offers no material (other than his allegation that he performed his part-time job adequately) to show that the Postal Service's refusal to certify him for a full-time job, on the ground that he was not medically qualified, was arbitrary, capricious, or violative of his rights. In the absence of any such

[1] *See, Welsh v. United States Postal Service,* 74 Civ. 3834 (S.D.N.Y. 1975), interpreting the Postal Service-Union Memorandum of Understanding relating to public policy employees and their status under the 1973 National Agreement between the Postal Service and the labor unions representing Service employees.

[2] Plaintiff states in his petition that he has a physical disability—he has been diagnosed by his own doctor as a spastic hemiplegic and has an irregular gait, one short leg and some spinal curvature. He contends that these physical problems did not hinder his part-time job performance and that he could have worked full time. Although the Postal Service had examined him and found him fit for his part-time job, the Service later decided that he would not be able to perform in a full-time position.

material from plaintiff, we cannot say that he has even raised a triable issue of fact as to his medical qualifications for full-time employment.

"IT IS THEREFORE ORDERED AND CONCLUDED that defendant's motion for summary judgment is granted and the petition is dismissed."

No. 485–76. SEPTEMBER 29, 1977

Otis W. King

Military pay; health care contracts (CHAMPUS); entitlement to benefits; exhaustion of administrative remedies; failure to state a claim upon which relief can be granted.—On September 29, 1977 the court entered the following order:

Marshall G. Kaplan, attorney of record for plaintiff.

Anthony Thompson, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG, and BENNETT, *Judges.*

"This action, a claim for benefits under the Military Medical Benefits Amendments of 1966, § 2(7), 10 U.S.C. § 1086 (1970) (hereinafter referred to as CHAMPUS), is before the court on defendant's motion for summary judgment.

"Plaintiff, a Second Lieutenant on the retired list of the United States Army who, defendant admits, qualifies for CHAMPUS benefits under Title 10 U.S.C. § 1086 (1970), asserts that the defendant has 'failed, neglected and refused' to pay medical bills that were 'reasonably incurred' by the plaintiff and 'compensable as CHAMPUS benefits.' Suit was initiated to recover $390,696.00 which plaintiff alleges was wrongfully withheld.

"Defendant rejects plaintiff's allegations, arguing that the claims were initially refused because plaintiff did not provide any supporting documentation and finally refused only after an independent examination of the plaintiff and a thorough evaluation through the standard administrative process. Defendant's basic contention is that plaintiff's

petition, even if all pleaded facts be accepted as true, fails to state a claim upon which relief can be granted.

"For the reasons discussed below, we find for the defendant and grant its motion for summary judgment.

"Commencing in January 1972, plaintiff submitted to the Medical Surgical Plan of New Jersey (the Plan), federal administrator for CHAMPUS benefits in the state, 32 C.F.R. § 577.71 (1976), various bills for treatment by physicians, inhalation therapists, and nurses, as well as the rental of certain durable medical equipment. Plaintiff claimed these services and equipment were necessary for the treatment of his 'chronic conditions,' but provided no diagnostic records to support this claim of necessity. The Plan, acting as evaluator of claims pursuant to its contract with the Secretary of Defense, 32 C.F.R. § 577.71 (1976), withheld payment for certain of the claims amounting to $390,696.00, for which it did not have sufficient information to determine whether they resulted from 'procedures and types of care ... which are generally accepted as being part of good medical practice . . . .' 32 C.F.R. § 577.64(b) (1976).

"Normal administrative procedure in instances where the Plan and an individual cannot agree concerning entitlement to benefits is to have the matter referred to a Peer Review Committee (Committee) composed of local physicians, pursuant to 32 C.F.R. § 577.82(a)(7)(1976), for analysis and recommendation. The Plan would then have an opportunity to concur in or dissent from the Committee's recommendation prior to a final determination of entitlement by the Office for the Civilian Health Medical Program of the Uniform Services (OCHAMPUS) in Denver, Colorado.

"Plaintiff sought initial resolution of his dispute with the Plan through the proper administrative channels. The Committee, however, deciding that it also had insufficient evidence on which to base a decision, requested supporting documentation from the plaintiff. When this was not forthcoming, the Committee alternatively suggested that plaintiff enter a teaching hospital near his home, at CHAMPUS expense, so that his condition could be evaluated and the appropriateness of the billed medical services

determined. After making initial arrangements to comply with this request, plaintiff unexpectedly reneged and, after receiving notice from the Committee that it could not recommend payment without some support, filed suit against the Federal Government in the United States District Court for the District of New Jersey.

"The U.S. Attorney's initial defensive thrust revolved around plaintiff's failure to exhaust his administrative remedies. Following a letter from the U.S. Attorney to plaintiff's Counsel which noted this defense and requested that plaintiff continue to seek administrative remedy, plaintiff "volunteered" to undergo the independent examination which he had earlier eschewed and agreed to submit the results to the Plan for resolution. A thorough study of the briefs and exhibits before us indicate that this examination was conducted with meticulous fairness to the plaintiff. His physicians were given every opportunity by the defendant to participate in the examination itself, although they made no effort to do so, and to evaluate and comment on the results. They were also afforded the opportunity to submit their own reports to the Committee for its consideration.

"After receiving this information from plaintiff's physicians, as well as the results of the independent examination, the Committee rendered its decision on November 3, 1975, recommending that payment be denied on the claims in question. This recommendation was approved by the Plan on December 2, 1975, and was adopted by OCHAMPUS on January 9, 1976. Six months later, the plaintiff's suit was dismissed by the District Court for lack of subject matter jurisdiction. This suit was instituted on December 1, 1976.

"While we agree with the District Court that jurisdiction over this matter is properly in the Court of Claims pursuant to 28 U.S.C. § 1346(d), we do not concur with the plaintiff's apparent inference that dismissal in the District Court implied a favorable resolution of plaintiff's claim in this court.

"What we have here is basically an attempt by plaintiff to turn his initial refusal and failure to exhaust his administrative remedies to his own advantage, despite the

fact that his subsequent utilization of the administrative process resulted in the justified denial of his claim. Although plaintiff's exact theory of recovery is unclear, he characterizes his suit as 'a run of the mill claim for insurance with which the local courts are familiar,' Brief for Plaintiff at 7, and further states that 'the fact that the government is the ultimate payee (sic) does not change the basic situation.' *Id.*

"The problem with this characterization is simply that plaintiff's claim is *not* merely a claim for payment under a private insurance contract; it is a claim for payment of benefits created by statute and payable from the national treasury. Regulations established by the Secretary of Defense under the authority of that same statute, the Military Medical Benefits Amendments of 1966, 10 U.S.C. 1071–1087 (1970), establish entitlements and provide administrative procedures through which eligibility of claimants and claims for payment are to be determined. 32 C.F.R. §§ 577.60–577.72. Plaintiff cannot escape these proper administrative channels merely by asserting that they do not exist, even though this is what he attempts to do.

"His first attempt at an 'end run' was his suit in the District Court. There he faced the compelling defense that he had failed to exhaust his administrative remedies. In what he characterizes as an 'attempt to settle,' he 'volunteered' to go through exactly the same procedures as he would have had he originally followed the delineated administrative appeal process. After a thorough and fair examination and appeal on all levels, plaintiff's claims were denied.

"Now, because of a dismissal for lack of subject matter jurisdiction in District Court, he again seeks to avoid the consequences of the administrative determination by suit in this court, apparently basing his petition on the contentions that his bills were reasonably incurred and should be compensable and that he has no administrative remedies. The basic fallacy in this position is that there is, in fact, a procedure established to determine the reasonableness and compensability of claims; it is the very procedure which plaintiff followed in his 'attempt to settle.'

The results of this administrative procedure can only be overturned upon a showing that the administrators 'acted arbitrarily, capriciously or were so grossly erroneous as to be in bad faith, as for instance where they may have acted without substantial evidence to support their decision or where they exceeded their authority.' *Morelli* v. *United States*, 177 Ct.Cl. 848, 858 (1966); *accord Schlegel* v. *United States*, 189 Ct.Cl. 30, 36, 416 F.2d 1372, 1375 (1969), *cert. denied*, 397 U.S. 1039 (1970).

"This is particularly so when, as in this case, 'experts may disagree [about matters involving] nice issues of judgment and choice . . . which require the exercise of informed discretion.' *Mountain States Telephone and Telegraph Co.* v. *United States*, 204 Ct.Cl. 521, 533, 499 F.2d 611 (1974), *quoting Panama Canal Co.* v. *Grace Lines, Inc.*, 356 U.S. 309 (1958).

"Interpreting the pleadings, as we must, in the light most favorable to the plaintiff, he has failed to allege any facts and has failed to raise any arguments which could conceivably lead to any conclusion of arbitrary or capricious action. Plaintiff himself phrased it best when he stated, 'this is a dispute between physicians . . . .' The physicians on the Committee, utilizing their 'informed discretion' rendered a decision. We see no basis on which to contest that determination. For this reason, we must dismiss plaintiff's petition for failure to state a claim upon which relief can be granted, and grant defendant's motion for summary judgment.

"IT IS THEREFORE ORDERED, upon consideration of the pleadings, defendant's motion for summary judgment and plaintiff's opposition thereto, without oral argument, that defendant's motion for summary judgment be and hereby is granted. The petition is dismissed."

No. 15–77. SEPTEMBER 29, 1977

Pathman Construction Company

Contracts; construction and purchase contract; escrow agreement; failure to exhaust administration remedies.—On September 29, 1977 the court entered the following order:

David I. Abse, attorney of record for plaintiff.

Frances L. Nunn, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, *Judge*, Presiding, KUNZIG, and BENNETT, *Judges*.

"This action, a claim for damages occasioned by defendant's alleged breach of contract, brought pursuant to 28 U.S.C. § 1491 (1970), is before the court on defendant's motion to dismiss and plaintiff's opposition thereto.

"Defendant contends that this case is prematurely before this court since plaintiff has failed to exhaust its administrative remedies as provided in the contract. Plaintiff counters with the assertions that either a 'novation' of the original contract or the absence of an actual 'dispute' rendered the 'dispute clause' remedies in the original contract ineffective and resulted in plaintiff's having no other recourse but to bring suit in this court. For the reasons stated below, we find for defendant and dismiss plaintiff's petition.

"The contractual relationship between plaintiff and defendant is controlled by three basic documents: their original contract in which plaintiff agreed to finance, construct and sell to defendant a certain building for a lump sum payment of $5,174,000; a subsequent purchase contract, in which the Government accepted ownership of and responsibility for the building; and an escrow agreement, executed on the same day as the purchase contract, by which the plaintiff placed in escrow $83,014.91 to insure completion of all omissions and repair of all defects remaining from the original contract.

"Sometime between the execution of the purchase contract and escrow agreement on October 1, 1974, and August 1975, both plaintiff and defendant became aware of 'existing aesthetic distress of the building roofing,' which had been constructed by plaintiff according to designs, plans, and specifications supplied by defendant. The problem was of sufficient significance to cause the Government to withhold repayment of plaintiff's escrow and to cause plaintiff to expend an additional $12,340 in an attempt to assess fault. Plaintiff's studies indicated that

defendant's designs were the cause of the problem, so, when letters to various Government officers failed to obtain release of the escrowed monies, plaintiff brought suit in this court to recover the amount held in escrow plus its additional expenditures.

"The major difficulty in plaintiff's claim here lies in the fact that it has failed to pursue the administrative remedies provided in the 'dispute clause' of the original contract it signed. These remedies consist of an initial finding of fact in writing by the contracting officer, followed by an appeal to the head of the agency.

"Plaintiff contends that it should be relieved from exhausting these remedies on either of two separate grounds. First, it argues that the purchase contract and the escrow agreement together constituted either a 'novation' or an 'accord and satisfaction' and thus rendered the dispute clause in the original contract inoperable. It is unnecessary, however, to address the niceties of contract law inherent in these arguments; the simple fact, ignored by the plaintiff, is that Article 15 of the purchase contract explicitly continues the obligations incurred by plaintiff in the original contract. This includes the obligation to settle disputes through the prescribed channels. In addition, the purchase contract, and its adjunct, the escrow agreement, were executed, not as a novation of the original contract, but in direct compliance with its terms. This would indicate that both parties believed the original contract still controlled their relationship.

"Second, plaintiff alternatively asserts that the dispute clause is without effect because there is no 'dispute.' Clearly, however, there is at least some question of fact concerning responsibility for the faulty roof. This disagreement, which involves numerous technical factors such as roof design, the properties of roofing material, and climate, seems particularly suited to initial resolution through administrative channels. While we indeed sympathize with plaintiff's frustration at its inability to prod a quick resolution of the matter from the defendant, we cannot accept plaintiff's characterization that a three-year delay by the Government in its 'attempt to determine the cause of failure of the original roofing' is equivalent to the

absence of a true factual dispute. Plaintiff's argument concerning the proportioning of the escrow account also raises a matter in dispute susceptible to administrative resolution. 'If relief can properly be granted under the [dispute clause of the] contract, the administrative procedure must be followed . . . .' *Zidell Explorations, Inc.* v. *United States*, 192 Ct.Cl. 331, 335, 427 F.2d 735, 737 (1970). For these reasons, we find that plaintiff has not exhausted its prescribed administrative remedies.

"IT IS THEREFORE ORDERED, upon consideration of the pleadings, defendant's motion to dismiss and plaintiff's opposition thereto, without oral argument, that defendant's motion to dismiss for failure to exhaust administrative remedies be and hereby is granted. The petition is dismissed."

No. 50–77. SEPTEMBER 29, 1977

Frank W. Sharp, et al.

Court of Claims jurisdiction; tort claim; closing of bank through Federal Deposit Insurance Company activities; alleged regulatory taking.—On September 29, 1977 the court entered the following order:

Charles Emmet Lucey, attorney of record for plaintiff. *Harrison, Lucey & Sagle*, of counsel.

Peter A. T. Sartin, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, *Judge*, Presiding, KUNZIG, and BENNETT, *Judges*.

"This action, a claim for compensation brought pursuant to the Fifth Amendment to the United States Constitution and the Tucker Act, 28 U.S.C. § 1491 (1973),[1] is before the

[1] Plaintiffs have initiated two suits in United States District Court for the District of Columbia which were based essentially on the same nucleus of operative facts. The first, C.A. No. 75–0230, was brought pursuant to the Administrative Procedure Act, 5 U.S.C. § 500, 701–04. It was dismissed because plaintiffs had stated a cause of action in tort for which the Federal Tort Claims Act (FTCA) provided the exclusive remedy, 28 U.S.C. § 2679, but had failed to comply with procedural requirements of the FTCA. This dismissal was affirmed by the Court of Appeals. *Sharp* v. *FDIC*, 535 F.2d 1325 (D.C. Cir. 1976). The second suit, C.A. No. 76–0176, filed after the dismissal

court on defendant's motion for summary judgment and plaintiffs' opposition thereto.

"Plaintiffs allege that 'over-regulation' by the Federal Deposit Insurance Corporation (FDIC) resulted in an unconstitutional taking of their interest in a successfully operating bank (Bank). Defendant counters with the assertion, *inter alia*, that, to the extent plaintiffs state a claim upon which relief can be granted, it is a claim sounding in tort which is not within the jurisdiction of this court. For the reasons stated below, we agree with the defendant.

"Viewing the pleadings in the light most favorable to the plaintiffs, we see a situation in which the local agents of the FDIC, through a variety of activities and actions, forced the closing of the Bank, in which plaintiffs were major shareholders, which was at that time solvent and operating smoothly.

"Plaintiffs primarily complain of four major actions by the FDIC which, they allege, constituted 'over-regulation' to such an extent as to rise to the level of unconstitutional taking. These were (1) 'directing' the Bank's board of directors to hire a new chairman and chief executive officer and designating the individual to be named; (2) 'directing' certain of the shareholders to pledge to the Bank free and clear title to certain improved real property, threatening to 'close and terminate the Bank's existence' if the pledge were not made; (3) 'caus[ing] the transfer and exchange' of substantial Bank assets, substituting in their place 'questionable assets . . . in the form of bad loans and credits' which 'lessened the value of the Bank's assets'; and (4) 'demand[ing] that the Directors adopt a resolution closing the Bank on grounds of insolvency,' even though the Bank was solvent at the time, reinforcing this demand by threatening unilaterally to close the Bank and by making various misrepresentations concerning the future intentions of the FDIC.

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of the first, was brought pursuant to the FTCA. It was dismissed, however, because plaintiffs had exceeded the two-year statute of limitations of the FTCA. 28 U.S.C. § 2401(b). Plaintiffs appealed, No. 76-1700, and the case was briefed and argued, but the appeal was withdrawn by stipulation prior to decision on January 21, 1977. This suit was filed on January 24, 1977.

"While we certainly concur in plaintiffs' assertion that regulation by a Government agency can become so overbearingly burdensome that it constitutes a taking of property compensable under the Fifth Amendment, *see, e.g., Benenson* v. *United States*, 212 Ct. Cl. 375, 548 F.2d 939 (1977), we do not believe that plaintiffs' petition properly alleges such 'over-regulation.'

"Initially, we note that the FDIC is nowhere given the authority unilaterally to take any of the actions it is alleged to have taken or compelled. *See* 12 U.S.C. §§ 1811–1831 (1969). The precise limits of FDIC corrective authority are well defined and action may be taken by the FDIC only with appropriate procedural safeguards and judicial supervision. *See, e.g.*, 12 U.S.C. § 1818(a)–(h).

"Since the FDIC did not have the power to take any of the actions complained of, the most literal reading of plaintiffs' petition would yield allegations that the FDIC or its agents had acted beyond the scope of their authority. This may state a claim upon which relief can be granted, but not in this court. The Court of Claims has no jurisdiction under 28 U.S.C. § 1491 (1973) to hear claims sounding in tort. *See, e.g., Eastport Steamship Corp.* v. *United States*, 178 Ct.Cl. 599, 607, 372 F.2d 1002, 1008–09 (1967).

"Alternatively, plaintiffs' petition could also be read to allege that, since the Bank was solvent and operating successfully, the FDIC or its agents acted wrongfully in influencing those who had the power—the board of directors, the Bank management, or the state banking authorities—to take the actions complained of. This claim also sounds in tort and is also beyond the jurisdiction of this court. *De-Tom Enterprises, Inc.* v. *United States*, 213 Ct.Cl. 362, 552 F.2d 337 (1977).

"The underlying difficulty in plaintiffs' petition is that the actions of the FDIC must have been either within or outside its scope of authority and must have been either justified or not justified by the financial condition of the Bank. If they were within the proper scope and justified by the diminished financial stability of the Bank—which plaintiffs cannot admit for fear of conceding that circumstances other than FDIC intervention diminished the value

of their property—then they were proper acts of regulation within the language of *Pennsylvania Coal Co.* v. *Mahon*, 260 U.S. 393,413 (1922), and its progeny. *Trone* v. *United States*, 213 Ct. Cl. 671 (1977). If the actions were beyond the authority of the FDIC or totally unjustified by the circumstances of the Bank—as plaintiffs allege—then the plaintiffs' claim must necessarily sound in tort and be beyond the jurisdiction of this court. Either way, plaintiffs' position cannot be logically maintained and we must find for defendant.

"IT IS THEREFORE ORDERED, upon consideration of the pleadings, defendant's motion for summary judgment and plaintiffs' opposition thereto, without oral argument, that defendant's motion be and hereby is granted and that plaintiffs' petition be and hereby is dismissed for failing to state a claim within the jurisdiction of this Court."

No. 77-77. SEPTEMBER 29, 1977

Clarence W. Shoemaker

Small Business Administration; refusal to extend additional funds; agency discretion; limitation of actions; tort claim.—On September 29, 1977 the court entered the following order:

Clarence W. Shoemaker, pro se.

Susan M. Linden, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

"This case is before the court on defendant's motion for summary judgment. On the parties' submissions, and without oral argument, we hold that the defendant's motion should be granted.[1]

"Plaintiff's case, very briefly, is a suit to recover damages that he allegedly suffered because the Small Business Administration (SBA) refused to loan money to him. In

[1] As a result, plaintiff's motion for appointment of counsel for the further prosecution of his suit is denied.

September 1969, plaintiff obtained a $70,000 SBA loan to fund his business, the Annawan Grain & Feed Company. Needing additional funds to improve and expand his business, he applied for a second loan later that year. His application for the second loan was denied by the SBA and plaintiff now alleges that his subsequent financial difficulties (including a Chapter XI bankruptcy) stemmed from the SBA's allegedly wrongful refusal to extend the additional funds. He has already tested out these allegations in actions in the Seventh Circuit,[2] receiving adverse decisions which the defendant asserts fully estop him here. We do not pause to consider this collateral estoppel defense because we are convinced that in any event plaintiff has not stated a claim within this court's jurisdiction.

"The decision whether to make an SBA loan is discretionary and plaintiff was therefore never legally entitled to receive the money at issue. *See, e.g., Bogart v. United States*, 210 Ct. Cl. 706, 707 (1976); *Raitport v. SBA*, 380 F. Supp. 1059 (E.D. Pa. 1974). At the time of his application for the second loan, plaintiff was already delinquent with his payments on his first loan and the SBA officials were certainly authorized to consider his previous payment record when deciding on his second application. There was clearly no abuse of discretion on this score. Plaintiff's allegations that certain SBA officials acted illegally, conspired against him, and made misrepresentations which caused him economic injury are wholly unsupported; moreover, such assertions pertain to a claim sounding in tort, and insofar as his suit seeks recovery for these alleged illegal acts it is not cognizable in this court. *See, e.g., Jackson v. United States*, 213 Ct. Cl.354, 591 F.2d 282 (1977); *McCreery v. United States*, 161 Ct. Cl. 484, 487–88 (1963).[3]

"In addition, plaintiff applied for the loan in 1969; his application was denied the same year. Suing under this court's Tucker Act jurisdiction, he is required to meet the

[2] *Shoemaker v. Dwyer and SBA*, No. RI-CIV 72–19, S.D. Ill., order of June 7, 1972, Morgan J., appeal dismissed as frivolous, U.S. Court of Appeals for the Seventh Circuit, order of Oct. 12, 1972, No. 72–1630, *cert. denied*, 412 U.S. 902 (1973).

[3] Similarly beyond our jurisdiction are plaintiff's demands for punitive damages (*Lewis v. United States*, 208 Ct. Cl. 969, 970 (1975)) and for damages for violation of constitutional equal protection. *Muehlen v. United States*, 209 Ct. Cl. 690 (1976).

Act's six-year statute of limitations. *See, e.g., Kabua v. United States,* 212 Ct. Cl. 160, 546 F.2d 381, *cert. denied* 434 U.S. 821 (1977). He filed in this court on February 4, 1977, more than seven years after the loan was denied, and his pleadings do not offer any legal bases upon which we could lift the bar imposed by the statute of limitations.

"Accordingly, because plaintiff's submissions do not make out a prima facie case on any grounds which are within our jurisdiction, IT IS ORDERED AND CONCLUDED that defendant's motion for summary judgment is granted and plaintiff's petition is dismissed."

No. 81-77. SEPTEMBER 29, 1977

Robert P. Bryan, Sr., and
Elizabeth S. Bryan

Taxes; income tax; civil actions for refund; necessity for filing claim for refund; limitations on credits; retirement income credit.—On September 29, 1977 the court entered the following order:

Robert P. Bryan, Sr., and *Elizabeth S. Bryan, Pro Se.*

William C. Rapp, with whom was *Acting Assistant Attorney General Myron C. Baum,* for defendant. *Theodore D. Peyser,* of counsel.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"This case for recovery of income taxes under 26 U.S.C. § 7422(a), Internal Revenue Code of 1954, comes before the court on cross-motions for summary judgment. There is no issue as to any material fact.

"These *pro se* plaintiffs assert an entitlement to $848.15 for retirement income credit (and an additional sum representing interest and costs) for the years 1969 through 1972. Plaintiffs first asserted their claim to the credit on January 15, 1977, which claim was denied as untimely by the Internal Revenue Service on February 1, 1977.

"Section 7422(a) of the Internal Revenue Code provides that no suit for the recovery of any income tax may be maintained in any court until a claim for refund has been

duly filed according to the provisions of law. Section 6511(a) specifies that claims for refund must be filed within 3 years from the time the returns are filed or 2 years from the time the tax is paid, whichever is later. No payments having been made after the filing of the four returns here in issue, the limitations periods ran from 3 years after the time of filing. Returns filed early are deemed filed on the last day prescribed for filing, section 6513(a), which was April 15 of each year following the tax years in question. Section 6072(a). Plaintiffs' returns here were filed on January 6, 1970, January 14, 1972,[1] January 9, 1972, and January 24, 1973. Thus, the statute of limitations expired as to all four claims before plaintiffs' letter of January 15, 1977.

"Plaintiffs argue that 'limitations periods normally in effect should be ignored in the judgment requested on the basis that defendant's instructions, in this instance, were misleading, unclear, and inadequate.' This allegation is unfounded, but in any case the jurisdictional requirement of a timely claim for refund stands paramount. The I.R.S. may not waive this requirement, *United States* v. *Garbutt Oil Co.*, 302 U.S. 528, 534, 535 (1938), but if it could, the court would not construe its letter to plaintiffs, informing them that they could file suit in district court or the Court of Claims, as such a waiver, the advice being merely informational.

"Plaintiffs argue, too, that information in the returns was sufficient to alert the Service of the plaintiffs' right to the retirement income credit, and they claim the defendant was negligent in failing to detect the error when processing the returns. This court has held that the I.R.S. is not required to sift the information on returns to see if the taxpayer might have a claim which is not stated. *Kuehn* v. *United States*, 202 Ct. Cl. 473, 478, 480 F. 2d 1319, 1322 (1973); *Barenfeld* v. *United States*, 194 Ct. Cl. 903, 912, 442 F. 2d 371, 375 (1971). This allegation by plaintiffs cannot

[1] There is some doubt that the return for 1970 was actually filed on January 9, 1972, the date stated on the return, since the return was due on April 15, 1971, and I.R.S. records fail to indicate the return was delinquent. Yet this issue is immaterial, because even if the return is deemed to have been filed on January 14, 1972, the limitations period would have expired on January 14, 1975.

vitiate the statutory requirement of a timely claim for refund.

"IT IS THEREFORE ORDERED that defendant's motion for summary judgment is granted, plaintiffs' motion for summary judgment is denied, and the petition is dismissed."

No. 148–77. SEPTEMBER 29, 1977

City of Santa Clara, California

Contracts; breach; availability of forum; comity; stay of proceedings; contract for electrical power.—On September 29, 1977 the court entered the following order:

Wallace L. Duncan, attorney of record for plaintiff. *Frederick D. Palmer, Edwin J. Moore,* and *Duncan, Brown, Weinberg & Palmer, P.C.* of counsel.

C. Max Vassanelli, with whom was *Stanley D. Rose* and *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG, and BENNETT, *Judges.*

"This case, a suit for damages for breach of contract brought pursuant to the Tucker Act, 28 U.S.C. § 1491, is before the court on defendant's motion to dismiss or, in the alternative, for a stay, and plaintiff's opposition thereto.

"Defendant contends that this suit should be dismissed, under 28 U.S.C. § 1500,[1] or stayed because action is still pending on a previous suit, *City of Santa Clara* v. *Kleppe,* 418 F.Supp. 1243 (N.D.Cal. 1976), which was initiated by the plaintiff and is based on the same nucleus of operative facts.

"Plaintiff responds by noting that the remedy sought here, money damages for breach of contract, is totally distinct from the declarative and injunctive remedies sought in the district court. Plaintiff further asserts the

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[1] 28 U.S.C. § 1500 reads in pertinent part:

The Court of Claims shall not have jurisdiction of any claim for or in respect to which the plaintiff or his assignee has pending in any other court any suit or process against the United States . . . .

impossibility of obtaining money damages from the Government in the amount sought here, possibly as much as $29.9 million, in the district court, 28 U.S.C. § 1346(b)(1976), and argues that defendant's motions must be denied because the relief sought here could not be obtained elsewhere.

"We agree that plaintiff has, in the strictest legal sense, requested a remedy here that is unavailable in the district court, and that our jurisdiction over the matter is, therefore, not barred by § 1500. There are, however, unique circumstances in this case. Because these circumstances raise a sufficiently high probability of plaintiff's receiving monetary relief without our intervention, we believe that we should stay proceedings in this court pending resolution of the related case.

"Plaintiff here, and in the district court, is the City of Santa Clara (City), a municipal corporation which supplies its citizens with electrical power. In an effort to reduce the cost of this electricity, plaintiff repeatedly attempted, between 1961 and 1965, to contract directly with the producer of the energy it received, the Central Valley Project (CVP), a water conservation project owned and operated by the United States Government, the defendant here, through the Secretary of the Interior, who was the defendant in plaintiff's district court action. The direct contract sought by plaintiff would have eliminated the 'middle-man,' Pacific Gas and Electric (PG&E), a utility company which purchased power from CVP, transmitted and resold it to the City at six times the initial cost.

"Finally, on November 30, 1965, the City and CVP signed a contract in which the CVP agreed to sell its excess power to the City on a temporary basis. This original agreement was amended several times, with each amendment increasing the electricity available to the City and expressly reserving the right to withdraw the same amount at any time with proper notice.

"In August of 1971, the CVP began unilaterally to make such withdrawals. As a result of these withdrawals, the City was again forced to purchase its power from PG&E at six times the cost. The City, however, alleging that the CVP had breached its contract, refused to pay the

additional sums to PG&E. Instead, it paid the money into an escrow account[2] pursuant to two escrow agreements with PG&E. In the latter of these two agreements, dated December 16, 1975, the City and PG&E agreed that their respective rights to the monies held in escrow should be determined by the outcome of a suit which the City had recently filed against the Secretary of the Interior in the United States District Court for the Northern District of California. In that action, *City of Santa Clara* v. *Kleppe*, 418 F.Supp. 1243 (N.D. Cal. 1976), the City had asked the court to declare that it had the right to receive CVP power and that it had, in fact, been using CVP power rather than PG&E power. The City also requested the court to enjoin the CVP from refusing further to allocate power to the City. The practical result, had the court granted the declarative and injunctive relief requested, is that the City would also have received, from the escrow account, money sufficient to compensate for any damages it suffered as a result of the Government's alleged breach of contract.

"The district court, however, neither granted nor denied the relief requested. Instead, it remanded the entire power allocation scheme for the region back to the Department of the Interior for further consideration and ordered the Department to grant to the City certain procedural due process rights which had been abridged in the first proceedings. Both parties have appealed this remand to the United States Court of Appeals for the Ninth Circuit.

"After it became apparent that its district court action would not quickly reach the desired resolution, the City brought suit here requesting money damages from the Government for breach of contract. The Government asserts that jurisdiction here is barred by § 1500 because final action is still pending in the district court case.

"We cannot agree with the Government's position. Although plaintiff's claim here is based on the same governmental action as is its suit in the district court, plaintiff has, in a strict legal sense, requested a remedy here that is totally unavailable in district court, payment of money damages in excess of $10,000 by the Government

[2] As of March 1, 1977, this escrow account showed a balance of $29,992,770.22.

for breach of contract. We do not believe that plaintiff should be denied the right ever to claim money damages merely because it also seeks to enjoin the Government from future power allotment violations by requesting injunctive relief in district court. *See Casman* v. *United States*, 135 Ct.Cl. 647 (1956). We conclude, therefore, that jurisdiction in this court is not precluded by 28 U.S.C. § 1500.

"However, the unique aspect of this case, the existence of an escrow account and the agreement between the City (plaintiff) and PG&E, make it probable that the *practical* effect of a district court decision in plaintiff's favor would be a substantial money recovery by the plaintiff. Such a money recovery could render the question of money damages moot and make further proceedings in this court unnecessary.

"Plaintiff did choose to initiate its litigation in the district court. It structured its escrow relationship with PG&E so that a final decision of that court in plaintiff's favor would, in all likelihood, result in a money recovery by the plaintiff. The district court, in its wisdom, has initiated a process which, though time-consuming, is calculated to bring about a just resolution. Any attempt on our part to resolve plaintiff's claim at this time would result in our hearing the same arguments on many of the same issues as did the district court. The possibility of inconsistent judicial resolution of similar legal issues would then exist and the dual proceedings could result in unfair burden to the defendant, an unnecessary crowding of this court's docket, and general administrative chaos. We do not believe it to be in the best interests of comity, justice or judicial administration for us to "leap in" at this point. *Cf. Tecon Engineers, Inc.* v. *United States*, 170 Ct.Cl. 389, 394, 343 F.2d 943, 946 (1965), *cert. denied* 382 U.S. 976 (1966), (Where jurisdiction concurrent, comity requires that court of first filing should proceed to resolution); *PPG Industries* v. *Continental Oil Co.*, 478 F.2d 674, 680 (5th Cir. 1973), Federal court stays proceedings pending resolution of parallel litigation in state court).

"For the reasons discussed above, we conclude that defendant's motion to dismiss for lack of jurisdiction should

be denied, but that its alternative motion to stay these proceedings pending the outcome of the litigation currently being pursued in the district court should be granted.

"IT IS HEREBY ORDERED, upon consideration of the pleadings, defendant's motions and plaintiff's opposition thereto, without oral argument, that defendant's motion to dismiss is denied and that defendant's motion to stay these proceedings is granted. These proceedings are stayed and counsel for the parties are ordered to notify this court of the judgment of the district court, within ninety days of the date it becomes final, and to file appropriate motions with this court at that time."

No. 168–77. SEPTEMBER 29, 1977

Francis P. McCourt

Civilian pay; adverse personnel action; legal expenses; tort claim.—On September 29, 1977 the court entered the following order:

Robert M. White, attorney of record, for plaintiff.

Robert M. Hollis, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"This case comes before the court on defendant's motion to dismiss for lack of jurisdiction and for failure to state a claim for which relief can be granted, plaintiff's opposition thereto (styled 'Reply'), and defendant's reply.

"Plaintiff was aggrieved by adverse personnel actions by the Department of the Army, for which he is a civilian employee. He filed suit in the Eastern District of Virginia, seeking promotion and back pay. The requested relief was granted, following a favorable decision by the Fourth Circuit. *McCourt* v. *Hampton,* 514 F.2d 1365 (4th Cir. 1975). Plaintiff has sued the above-captioned defendants for legal expenses incurred and tortious injuries sustained as a result of the wrongful personnel actions.

"Plaintiff now concedes that the action must be dismissed against the United States Civil Service Commission

and the Department of the Army. The claims against the United States must be dismissed also.

"It is abundantly clear that the United States cannot be made to pay legal expenses absent the authorization of a specific statute or contractual provision. 28 U.S.C. § 2412 (1970); *Alyeska Pipeline Serv. Co.* v. *Wilderness Soc'y*, 421 U.S. 240 (1975); *Fitzgerald* v. *United States Civil Serv. Comm'n*, 554 F.2d 1186 (1977); *J. E. Robertson Co.* v. *United States*, 194 Ct. Cl. 289, 296–97, 437 F.2d 1360, 1364 (1971). Plaintiff has not cited, nor can we find, a statute or contractual provision providing such authorization in the circumstances of this case. Accordingly, this claim must be dismissed for failure to state a claim for which relief can be granted.

"Plaintiff argues that its tort claims are cognizable here under the theory of pendent jurisdiction. This contention is doubly flawed. First, as above stated, the claim for legal expenses must be dismissed, so no occasion arises for considering the merits of an argument based on pendent jurisdiction. Second, this court may not adjudicate tort claims, which have been reserved exclusively to the district courts. 28 U.S.C. §§ 1346(b), 1491 (1970).

"NOW THEREFORE IT IS ORDERED that, upon the written submissions of the parties, and without oral argument, defendant's motion to dismiss be, and it hereby is, granted. The petition is dismissed."

No. 185–77. SEPTEMBER 29, 1977

Robert L. Brewster

Court of Claims jurisdiction.—On September 29, 1977 the court entered the following order:

Robert L. Brewster, pro se.

Lynn J. Bush, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"This case comes before the court on defendant's motion to dismiss for failure to state a claim for which relief can be

granted and for want of jurisdiction, plaintiff's opposition thereto, and defendant's reply.

"*Pro se* plaintiff's four-count petition claims entitlement to money damages for:

> I. assorted derelictions of duty by the Federal Election Commission, including the giving of unfair competitive advantage to major party candidates and the violation of plaintiff's constitutional rights to freedom from discrimination upon racial, religious, and associational grounds;
>
> II. improprieties by the United States Postal Service in the handling of mail relating to plaintiff's campaign for President on the Christian (nonlawyer) Party ticket;
>
> III. breach of an implied warranty by the Veterans' Administration for the provision of adequate medical treatment; and
>
> IV. wrongful dismissals of various suits brought in federal courts by plaintiff.

"Counts I, II, and IV fail to state claims cognizable by the Court of Claims. None of these counts is based on contracts with the United States, on any constitutional provision or statute or regulation fairly interpretable as mandating compensation by the Federal Government, or on the illegal exaction, or retention, of monies paid to the Government. *See United States* v. *Testan*, 424 U.S. 392, 400, 401–02 (1976); *Eastport S.S. Corp.* v. *United States*, 178 Ct. Cl. 599, 372 F. 2d 1002 (1967). To the extent plaintiff may have stated causes of action, they would sound in tort and thus are beyond this court's limited jurisdiction under 28 U.S.C. § 1491 (1970).

"Count III, too, must fall. Although plaintiff's claim is cast as one for breach of implied warranties in an implied contract, he offers no basis for a conclusion that he had an implied-in-fact contract with the Veterans Administration for medical treatment. Indeed, such a showing would be virtually inconceivable, since the entitlement of veterans to VA hospital care and medical treatment is a matter of statute, 38 U.S.C. §§ 610–612 (1970), and regulation, rather than contract. Accordingly, there being no contract, inquiry into the scope of possible implied warranties is not

appropriate. Plaintiff's remedy, if any, would be under the Federal Tort Claims Act, which was the remedy explained to plaintiff by letter of Veterans Administration District Counsel George Moseley. Plaintiff explains he 'elected' not to pursue his Tort Claims Act remedy but to sue in the Court of Claims. He did not have this option because the court lacks the jurisdiction to adjudicate claims, such as this one, grounded essentially in tort.

"IT IS THEREFORE ORDERED that defendant's motion to dismiss be, and it hereby is, granted. The petition is dismissed."

No. 138–74. SEPTEMBER 30, 1977

Cousins Properties, Incorporated

Taxes; income tax; capital gains and losses; capital asset; property held primarily for sale; real estate.—Plaintiff seeks to recover federal income taxes and assessed interest paid for taxable years 1964–1967. This case involves a determination of whether the gains from sales or exchanges by plaintiff in each of eight different real estate transactions qualify for capital gains treatment under the provisions of 26 U.S.C. § 1221 or § 1231, or whether they should be taxed as ordinary income. Each of the properties involved was held by plaintiff for more than 6 months. In a recommended decision filed July 1, 1977 (reported in full at 40 AFTR 2d 77–5262 and 77–2 USTC para. 9508) Trial Judge Francis C. Browne discussed at length the various transactions involved, and on the basis of the evidence concluded that as to six of the parcels of real property the primary purpose in holding the property was to maintain a source of recurring income, entitling plaintiff to capital gains treatment on the gains from their sale or exchange; as to the remaining two parcels, these were held primarily for sale to customers in the ordinary course of plaintiff's real estate business and accordingly plaintiff realized ordinary income from the sales. On September 30, 1977 the court, by order, adopted the recommended decision as the basis for its judgment in this case, dismissed the petition as to the sales of two parcels, entered judgment in favor of plaintiff in the amount of the deficiency assessment paid plus

statutory interest respecting the other six parcels, and reserved the exact amount of plaintiff's judgment for further proceedings under Rule 131(c). On December 16, 1977 the court entered judgments as follows:

1964–$16,178.51
1965–228,927.60
1966–309,413.50
1967–313,086.34

plus interest as provided by law, or a total amount of $867,605.95, plus interest as provided by law. For purposes of computing statutory interest to be paid on the refund respecting year 1966, the date of overpayment by plaintiff is deemed to be June 23, 1970.

No. 54–76. SEPTEMBER 30, 1977

Santa Fe Engineers, Inc.

Contracts; disputes; warranty re specification and drawings; adequacy of administrative record; remand to administrative board.—Plaintiff was awarded contracts for construction of facilities for Minuteman III re-entry systems at Minot Air Force Base, North Dakota, and at Malmstrom Air Force Base, Montana. Plaintiff subcontracted all of the electrical work on the two projects, and here seeks review of a decision of the ASBCA denying its claim, on behalf of the subcontractor, to equitable adjustments in contract price under the changes clause in consequence of allegedly defective specifications and drawings respecting the extent of the electrical work required. On May 24, 1977 Trial Judge Harry E. Wood filed a recommended decision (reported in full at 23 CCF para. 81,335) determining that of the six specifically enumerated claims three were supported by the administrative record. As to one of the remaining three claims, the board's determination is unsupported by substantial evidence, is directly contradicted by the proof before it, and cannot be sustained; plaintiff is entitled to an equitable adjustment under the changes clause; the precise extent of the change cannot be and has not been considered. As to another of the

remaining three claims, the board decision is not entitled to finality, and the administrative record does not permit an informed decision respecting plaintiff's right to an equitable adjustment. As to the last claim, the board's decision respecting a portion thereof is so inadequate in terms of fact finding and reasoned conclusions as to amount to no decision at all. The latter three claims should accordingly be remanded to the board. On September 30, 1977 the court, by order, adopted the recommended decision as the basis for its judgment in this case, remanded the cause to the board for further administrative proceedings on claims 8, 10 and a portion of claim 13, and stayed proceedings in this court.

No. 239–76. SEPTEMBER 30, 1977

Penn York Construction Corporation
and Acro-V Builders Corporation,
a joint venture

Contracts; disputes; acceleration of work claim; computation of equitable adjustment; total cost theory; sufficiency of evidence; manpower loading.—The ASBCA determined that plaintiff was entitled to an equitable adjustment for acceleration under a contract for construction of Nike-Hercules facilities in Dade County, Florida, and remanded to the parties the matter of the amount thereof, for resolution by agreement or, that failing, by unilateral determination of the contracting officer. The contracting officer allowed a stated sum on the ground of plaintiff's failure to show that the equitable adjustment due it "should exceed the amount found by the contracting officer." Plaintiff seeks Wunderlich Act review of this determination. In a recommended decision filed June 20, 1977 (reported in full at 23 CCF para. 81,438) Trial Judge Harry E. Wood concluded that plaintiff is not entitled to recover, rejecting plaintiff's proffered adjusted total cost theory on the ground that it is purely theoretical and speculative, and also rejecting plaintiff's contention that the board should have compared plaintiff's actual manpower loading with its scheduled manpower loading, adjusted to reflect either the extended completion dates as

determined by the board or the actual completion dates. On September 30, 1977 the court, by order, adopted the recommended decision as the basis for its judgment in this case, ordered that plaintiff is not entitled to recover, and dismissed the petition.

No. 399–76. SEPTEMBER 30, 1977

Henry O. Shaw and Mary H. Shaw, et al.

Lease; suit for rent payments; lease termination upon notice; setoff for cost of services and utilities saved by early vacating of premises.—On September 30, 1977 the court entered the following order:

Henry H. Harnage, attorney of record for plaintiff. *Worley, Gautier & Sams,* of counsel.

James R. Arnold, with whom was *Acting Assistant Attorney General James W. Moorman,* for defendant.

Before DAVIS, *Judge,* Presiding, NICHOLS and KASHIWA, *Judges.*

"This case comes before the court on plaintiffs' motion for partial summary judgment.

"Plaintiffs' suit is for $52,926.05 in rent payments due under a lease of office space in the Shaw Maritime Building, 501 N.E. First Avenue, Miami, Florida, entered into between the parties on November 27, 1973. The lease No. GS–04B–15002, was for a term commencing December 1, 1973, and terminating November 30, 1978, subject to a clause permitting the Government to terminate the lease after November 30, 1976, upon 60 days' written notice. Under the lease, the annual rental for the period December 1, 1973, through November 30, 1976, was $38,227, payable at the rate of $3,185.58 per month in arrears. (See Exhibit A, plaintiffs' petition). The lease also provides an annual rental of $39,102 for the period December 1, 1976, through November 30, 1978, payable at the rate of $3,258.50 per month in arrears.

"The Government took possession of the premises on December 1, 1973. In a letter dated October 15, 1975,

defendant advised plaintiffs that it was terminating the lease as of August 31, 1975, for failure to comply with certain terms in the lease concerning maintenance and habitability of the premises. Plaintiffs successfully sued defendant in the United States District Court for the Southern District of Florida for the rent installments due on October 1, 1975, and November 1, 1975. Defendant's appeal from final judgment, to the United States Circuit Court of Appeals for the Fifth Circuit, was dismissed on September 15, 1976.

"The subject of this suit is the rents due and owing for the period from December 1, 1975, until March 16, 1977, the date on which the lease was properly terminated upon the prescribed 60 days' written notice to plaintiff. Defendant admits the foregoing facts and does not dispute its liability to pay rent for this period. In its answer, however, defendant contends that it is entitled to an equitable setoff in the amount of $12,638.45. This amount is based on an estimate of the cost of services and utilities which plaintiff would have been obligated to furnish had the premises been occupied.

"United States Court of Claims Rule 101(d) provides that a partial summary judgment may be rendered on the issue of liability alone when there remains a genuine issue as to the extent of damages. Defendant, in its pleadings, consents to a judgment in the amount of $40,258.59, which is the rent owed, diminished by defendant's estimate of the costs saved by plaintiff as a result of the early vacation of the premises. Consequently, there is no issue as to the liability of the United States to pay rent for the premises for the period from December 1, 1975, until March 16, 1977; the only issue to be resolved is the validity and amount of the equitable setoff claimed by defendant. Until this latter issue is litigated, however, it would not be appropriate to enter judgment for a sum certain.

"IT IS THEREFORE ORDERED AND CONCLUDED that, upon the written submissions of the parties, and without oral argument, plaintiffs' motion for partial summary judgment in its favor on the question of defendant's liability to pay rent for the period from December 1, 1975, until March 16,

1977, is granted. The case is remanded to the Trial Division for further proceedings on the issue of damages."

In accordance with the foregoing order, a stipulation of the parties and a memorandum report of the trial judge as to the amount due plaintiff, it was ordered on November 4, 1977 that judgment for plaintiff be entered for $44,500.42.

No. 342-75. SEPTEMBER 30, 1977

Allied Materials & Equipment Co., Inc.

Contracts; breach; cardinal change; administrative board termination settlement; measure of recovery; charge of Government bad faith; burden of proof.—On September 30, 1977 the court entered the following order:

Charles E. Raley, attorney of record for plaintiff. *Israel and Raley,* of counsel.

Robert M. Hollis, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before NICHOLS, *Judge,* Presiding, KASHIWA and BENNETT, *Judges.*

"Both defendant and plaintiff move for summary judgment in this contract case, which has already been the subject of an opinion of the Armed Services Board of Contract Appeals (ASBCA), 75-1 BCA ¶ 11,150, and an order of our court, 210 Ct. Cl. 714 (1976). We deny both motions and remand for trial.

"In January 1970, plaintiff entered into two contracts with the Army, the one to supply armored-tank engine components, and the other to obtain access to sufficient Government-owned tools and facilities to perform the supply contract. Shortly after the contracts were awarded, however, the General Services Administration, which apparently controlled the Government-owned plant and equipment made available to plaintiff, sold that facility to a subsidiary of Teledyne Corporation, which had been, until these contracts with plaintiff, the Government's sole source for the engine components involved here. Defendant failed to reserve for plaintiff the right to continue using the

facility after sale, and Teledyne's subsidiary promptly denied plaintiff access to the machinery it needed to perform the contract. For several weeks, plaintiff and defendant discussed extending the contract delivery schedule, allowing plaintiff an equitable increase in the contract price, and securing substitute equipment with which to complete the contract, but agreement was beyond the parties' reach. On July 30, 1971, defendant terminated the contract for its convenience, and negotiations between the parties turned toward arranging an acceptable settlement of the contract. Eventually, the parties executed the bilateral termination settlement, which the ASBCA held was unreasonably low in the amount allowed plaintiff. The Board further found that plaintiff accepted it under duress as a result of improper economic pressure, accentuated by defendant's unlawful acts. It imputed bad faith in general to defendant's conduct following the termination. The Board increased plaintiff's termination settlement, but could not, consistent with the termination clause of the contract, award plaintiff any amount representing unearned but anticipated profits on the whole contract.

"Plaintiff now seeks anticipated profits in this suit, brought directly to this court and not based upon a Wunderlich Act challenge to the Board's decision or findings. Plaintiff alleges a breach of contract, the essence of which is that defendant's sale of necessary production facilities without protecting its contractor rendered the contract impossible to perform. Plaintiff's briefs also describe various other acts by defendant prior to terminating the contract that are said to indicate defendant's bad faith.

"There may be a sufficient foundation for our de novo jurisdiction in this case if plaintiff proves only a breach of contract, not remediable by change order. The trial judge may find that defendant's denying plaintiff its means of production, constituted a cardinal change of the work required under the contract, *Edward R. Marden Corp.* v. *United States*, 194 Ct. Cl. 799, 442 F.2d 364 (1971), and placed defendant in breach. Once plaintiff succeeds in invoking our jurisdiction, though, it will need to show more than just a breach before it can add to what the Board

awarded it as a termination settlement, because the Government may no less limit its liabilities through the termination for convenience clause even if it has already breached the contract. *See College Point Boat Corp.* v. *United States*, 267 U.S. 12 (1925). The very purpose of the termination clause is to enable the Government to avoid paying what damages the common law would prescribe for a contract breach. *Nolan Bros.* v. *United States*, 186 Ct. Cl. 602, 608, 405 F.2d 1250, citing *G. L. Christian & Assocs.* v. *United States*, 160 Ct. Cl. 1, 312 F.2d 418, *cert. denied*, 375 U.S. 954 (1963). The clause operates to bring within the contract disputes that would otherwise have been without. In an ordinary case, we would expect that the Board's award under the disputes process would be a contractor's full measure of recovery.

"But we have recognized a doctrine that restricts the Government's resort to the termination clause to instances where the Government acts in good faith, *see John Reiner & Co.* v. *United States*, 163 Ct. Cl. 381, 390, 325 F.2d 438, 442 (1963), *cert. denied* 377 U.S. 931 (1964), and bears no malice against the contractor, *see Colonial Metals Co.* v. *United States*, 204 Ct. Cl. 320, 331, 494 F.2d 1355, 1361 (1974). However sweeping its prerogative to declare a contract terminated for convenience, the Government cannot insulate itself from common law liability if it abuses its discretion or acts in bad faith. Inasmuch as this appears to be plaintiff's theory of recovery, we disagree with defendant that plaintiff fails to present a triable issue of fact, and we deny defendant's motion.

"The facts in this record are not of a nature to fit this case for disposition upon summary judgment. As we see it, plaintiff's recovery depends on its ability to prove the Government's bad faith. The Board's decision did find the Government guilty of bad faith, but only after it terminated the contract, and the Board made no such finding regarding the preceding months to which plaintiff now directs our attention. The Board did not need to explore this far back because its sole concern was the termination settlement. Its remedy, appropriately, was to restore to plaintiff the full measure of what it would have received to settle the contract had defendant negotiated fairly. The

Board's carefully documented fact recitals tell a horrendous story, and suffice by themselves to tender a triable issue as to when bad faith began to control defendant's acts. Defendant's affidavits are not sufficient refutation for summary judgment purposes in face of the Board findings. The Board's findings as to the termination and events leading up to it, thus are inferentially relevant to our inquiry, and therefore admissible into evidence now, *see National Factors, Inc.* v. *United States*, 204 Ct. Cl. 98, 492 F.2d 1383 (1974), but they are not dispositive. The record leaves open factual questions that are essential for our decision, and both parties have the right and duty in a breach case to present the evidence in full.

"Our need for a trial in this case is clear, to develop the following issues, at least, in addition to whatever else the trial judge finds would aid our resolving this case. First, the trial judge should determine whether the Government's sale of facilities was, under all the circumstances, a cardinal change of the contract under *Edward R. Marden Corp., supra*, that constitutes the Government's breach of the contract. Our jurisdiction depends upon finding some breach, but unless the facilities sale generated a cardinal change, for which a contractor could not be compensated amply with money in the form of an equitable adjustment to the contract price, the facilities sale loses its significance as a breach. Second, assuming the trial judge finds that defendant breached the contract, he should determine whether it thereafter invoked the termination clause in bad faith, so that it is prevented from benefitting from the limitation of liability provided there. In this regard, the parties may find instructive Commissioner W. Ney Evans' recommended opinion in *Weiss* v. *United States*, 155 Ct. Cl. 825 (1961), in evaluating the quality of evidence that plaintiff must present in order to establish the Government's bad faith. In *Weiss*, Commissioner Evans found the evidence sufficient to establish the Government's bad faith prima facie, which was as far as he needed to go to resolve the dispute over discovery then before him. The case was eventually settled out of court and before trial, so ultimate findings were never rendered. Nor was the commissioner's opinion ever adopted by the court, although published

officially. In this light, plaintiff here should harbor no illusions that the task of overcoming the presumption that Government officials perform their duty in good faith is less than burdensome. *Kalvar Corp.* v. *United States*, 211 Ct. Cl. 192, 543 F.2d 1298 (1976); *Librach* v. *United States*, 147 Ct. Cl. 605 (1959).

"Accordingly, IT IS ORDERED that defendant's motion and plaintiff's cross-motion for summary judgment are denied, and the case remanded for trial consistent with this order."

See report of opinion of the court filed January 25, 1978, *ante* at 406.

No. 113-77. SEPTEMBER 30, 1977

Morton H. Jaffe, et al.

Court of Claims jurisdiction; pendency of claim in another court.—On September 30, 1977 the court entered the following order:

Neal L. Grossman, attorney of record, for plaintiffs. *Neal L. Grossman & Associates*, of counsel.

Julie P. Dubick, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This case is before the court, without oral argument, on defendant's motion to dismiss pursuant to 28 U.S.C. § 1500 (1970), which denies jurisdiction to this court of any claim against the United States which plaintiff has pending in any other court.

"The plaintiffs are holders of bonds issued by the City of East St. Louis in connection with the Martin Luther King Bridge spanning the Mississippi River between Missouri and Illinois. Debt service on the bonds was supported solely by tolls from the operation of the bridge. The plaintiffs allege that, as a result of the opening of a new toll-free bridge built by the United States and the Department of Transportation of the State of Illinois in cooperation with the City of East St. Louis (which had covenanted under the trust agreement for plaintiffs' bonds not to allow the

construction of an additional bridge within the city limits), the revenues generated from the tolls became inadequate to cover even the maintenance of the bridge. On January 1, 1974 a default occurred on the payment of some of the bonds. The petition in the instant case was filed on February 24, 1977. The plaintiffs both on their own behalf and on behalf of other bondholders under the same trust agreement contend that they have suffered a deprivation of property without just compensation and also allege claims under various sections of Title 23 of the United States Code.

"The defendant urges that the case be dismissed pursuant to 28 U.S.C. § 1500 (1970), since in *Jackson Sawmill Co. v. United States*, C.A. No. 76–596C(3) (E.D. Mo.) (filed June 30, 1976) the named plaintiffs, who differ from those in the instant case, make virtually identical claims on their own behalf and on behalf of other bondholders under the trust agreement, whose class they seek to represent, as do the plaintiffs before this court.

"The plaintiffs in their Resistance to Motion to Dismiss Pending Petition for Damages state that they have no other case pending against the United States. In addition, they declare that if they should receive notice that the *Jackson Sawmill* case has been certified as a class action, they will request exclusion therefrom. Also, on August 4, 1977, an order was filed in *Jackson Sawmill* dismissing the case with prejudice in regard to the United States, William T. Coleman, the Secretary of Transportation of the United States, William Mason, the Mayor of the City of East St. Louis, and Jack Curtis, the Chairman of the State Highway Commission of Missouri.

"There are two reasons for denying the defendant's motion. First, the *Jackson Sawmill* case has been dismissed as against the federal defendants in that case (including the United States) and therefore 28 U.S.C. § 1500 can no longer apply. Second, none of the plaintiffs in the case at bar is a plaintiff in the *Jackson Sawmill* case and none intends to participate in a class action in the district court case, if it should be certified as a class action. For these two reasons it is clear that there is no basis under 28 U.S.C. § 1500 (1970), either for dismissing the action or for staying

further action pending the outcome of the proceedings in the district court case.[1]

"IT IS THEREFORE ORDERED AND CONCLUDED that defendant's Motion to Dismiss the Petition be denied and that the case be remanded to the Trial Division for further proceedings.[2]

On November 25, 1977 the court denied defendant's motion for rehearing to alter and amend the judgment entered September 30, 1977, provided that the trial judge may have discretion to stay further proceedings in this case until disposition by the Circuit Court of Appeals of the appeal referred to by the parties in the said motion and opposition thereto.

No. 486-76. SEPTEMBER 30, 1977

Timothy Eugene Shelton

Military pay; enlistment contract.—On September 30, 1977 the court entered the following order:

Virginia S. Carson, attorney of record for plaintiff.

Lynn J. Bush, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, NICHOLS and KASHIWA, *Judges.*

"Defendant moves for summary judgment in this military pay case. The motion is denied and the cause remanded to the Trial Division for further proceedings.

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[1] In *Alden v. United States,* Ct. Cl. No. 167-75 (order filed February 13, 1976), the defendant urged dismissal of the case under 28 U.S.C. § 1500 (1970) on the ground that plaintiffs had pending a tort action against the United States and its agents arising from the same factual circumstances. The court concluded, however, that the interests of justice would be better served by staying the proceedings pending the outcome of the district court action or for a period of six months, whichever came first. The same type of suspension has been ordered or put into effect in a number of other cases.

[2] Defendant's motion (filed June 24, 1977) to file out of time its motion to stay proceedings on plaintiffs' motions filed February 24, March 15, and April 5, 1977, is granted, as is the accompanying motion to stay proceedings on those three motions of plaintiffs. The plaintiffs' said three motions are referred to the trial judge for appropriate action.

"The following facts are admitted by the parties at least for purposes of the motion, except where attributed to one side only. Plaintiff served four years in the United States Army, ending by honorable discharge February 8, 1971, at enlisted pay grade E–6. Thereafter to March 1975, he served as a police officer of the Germantown, Ohio, force, rising to the rank of Sergeant at a salary of $9,200. That month he was in contact with military recruiters and discussed returning to the regular Army under the 'Stripes for Skills' program to serve as a military policeman in the 95B20 classification. The program and classification are unfamiliar to the court and not explained by the parties. He stated he had family responsibilities and could accept enlistment into the E–5 grade but no lower. Later, in August, he signed a formal 'Enlistment Contract' specifying that he would receive promotion to E–5 after eight weeks. An annex to the contract reflects that he is to enter the reserves and make a 'delayed entry' into the regular. This document says he will take an Army school course on enlistment, which will qualify him for Grade E–4. In that annex, the grade 'E–5' is stricken out and 'E–4' substituted, with plaintiff's initials beside it, to denote that the change was made before signature. Neil C. Green, Master Sergeant, says by affidavit he was a supervisor of Guidance Counselors at Cincinnati, that he discovered that the contract promised plaintiff an E–5 after completing the school, that he learned the regulations allowed only E–4, that he so advised plaintiff before he took the oath of enlistment, that plaintiff accepted the enlistment oath with full knowledge he would not be eligible for E–5 on completing the probational training. Plaintiff, however, in a counter affidavit, says that in initialing the correction he understood he was entering the reserves while the matter of his ultimate grade was checked out, and later he reported back, was told he could qualify for E–5, and was sworn into the Regular Army. The fact that only the annex was corrected to show E–4, not the main body of the contract, lends some support to plaintiff's version.

"Plaintiff completed his preliminary school or training and served as E–4 for a brief period. On December 16, 1975, he requested that he be discharged immediately for

erroneous enlistment. This was done effective February 4, 1976.

"The failure of the Army to fulfill its E–5 commitment, as alleged, had, he says, various collateral consequences, including repossession of his mobile home and car, loss of his former job and status as a police sergeant, denial of unemployment benefits, etc. He claims: $8,000 to purchase a mobile home, $4,200 to purchase a car, $3,100 for lost salary as an E–5 to the present date, $1,000 for lost Army benefits, $200 as the difference between E–4 and E–5 pay from the promotion to E–4 to the discharge, $50,000 for loss of conjugal benefits, $100,000 for lost retirement benefits, $50,000 for loss of credit rating, and $5,000 for costs and attorney's fees.

"A soldier's pay rights formerly were considered to be matters of status, not contract, acquired by appointment and stemming from law or legally authorized regulations. In introducing the express contract of enlistment, the military have presented the court with a novel situation for it, and it must be careful not to take steps that may be regretted on receipt of fuller information. In *Jackson* v. *United States*, 213 Ct. Cl. 354, 551 F.2d 282 (1977), plaintiff enlisted under such a written contract, but based his suit on an alleged oral agreement *dehors* it, not on the contract terms themselves as here. Defendant has assumed rather than briefed the incompatibility of plaintiff's promised E–5 with governing regulation. Defendant's own personnel seem to have been uncertain as to the existence of an absolute unwaivable bar, and in face of such uncertainty we think defendant should bear the burden of showing what the regulations it relies on provided. The incomplete correction of the contract, rather than precluding factual investigation, invites it, to ascertain what the true intent of the parties was, and whether the contract should be reformed to reflect that intent. We can agree with defendant that its officers cannot bind it to a contract the law does not authorize them to make, without feeling entire confidence that the contract sued on here is of that character. The entire situation here calls for careful inquiry by a trial judge.

"Assuming that contract rather than status governs here, it would apparently follow that a claim based on an 'enlistment contract' would not be unwaivable, as status claims are, but, on the contrary, could be waived. It would appear likely that, in applying for a discharge 'due to erroneous enlistment' as plaintiff did, without any express reservation of rights, plaintiff would have waived at least any claim to the monetary benefits of military status, accruing after the effective date of the discharge. The application with the discharge itself, would be deemed in contract law an 'accord and satisfaction,' we think, wherein defendant waived any claim for plaintiff's services during the remainder of the enlistment period, and plaintiff waived his claim for the emoluments of such service. There might be exceptional situations, as, *e.g.*, duress, but they would have to be pleaded and proven.

"It is well settled that tort claims cannot be allowed as pendant on claims for breach of contract. *Jackson* v. *United States, supra; Algonac Mfg. Co.* v. *United States*, 192 Ct. Cl. 649, 428 F.2d 1241 (1970); *Benjamin* v. *United States*, 172 Ct. Cl. 118, 348 F.2d 502 (1965). Except for the claim for $200, difference between E–4 and E–5 pay from promotion to discharge, all claims may well smack of a tortious character in view of the above authorities. Assuming the Trial Division is satisfied that plaintiff is entitled to recover in some amount, the quantum of recovery will remain for careful consideration by the Trial Division in light of contract principles.

"Accordingly, in view of the foregoing, the defendant's motion for summary judgment is denied and the case is remanded to the Trial Division for further proceedings consistent with this order."

On plaintiff's motion to dismiss, endorsed "No objection" by defendant, the petition was dismissed on August 2, 1978.

No. 19–77. SEPTEMBER 30, 1977

Oscar Mayer & Co., Inc. (PA.)

Taxes; claim for refund; limitations on credit or refund; period of limitation.—On September 30, 1977 the court entered the following order:

Edward C. Rustigan, attorney of record, for plaintiff. *Mayer, Brown & Platt*, of counsel.

Allan C. Lewis, with whom was *Assistant Attorney General M. Carr Ferguson*, for defendant. *Theodore D. Peyser* and *Donald H. Olson*, of counsel.

Before DAVIS, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This tax refund suit is before the court on defendant's motion for summary judgment under Rule 101. Defendant contends that plaintiff-taxpayer failed to file a timely refund claim. Plaintiff has not filed a response to said motion of defendant.

"On July 18, 1974, taxpayer filed an amended return for the fiscal year ending October 31, 1970, which reflected an additional loss of $130,103 of that previously reported. On the same date taxpayer filed a claim for refund, attempting to carry this loss back to its fiscal year 1968. That claim for refund, however, was untimely under 26 U.S.C. § 6511(d)(2)(A) (1970) which states:

> (A) *Period of limitation.*—If the claim for credit or refund relates to an overpayment attributable to a net operating loss carryback, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be that period which ends with the 15th day of the 40th month (or the 39th month, in the case of a corporation) following the end of the taxable year of the net operating loss or net capital loss which results in such carryback, * * *.

The above provision requires, in the case of a corporation, that the claim be filed by the 15th day of the 39th month following the end of the taxable year of the net operating loss. As applied to the facts in this case, therefore, the claim for 1968 taxes, based upon a 1970 net operating loss, must have been filed by February 15, 1974. The actual filing date by the taxpayer was some five months after that. Therefore,

"IT IS ORDERED that without oral argument, upon consideration of defendant's motion, defendant's request of

summary judgment is granted. Plaintiff's petition is dismissed."

No. 342–77. SEPTEMBER 30, 1977

Herbert S. Silbert

Civilian pay; resignation; correction of records; Court of Claims jurisdiction.—On September 30, 1977 the court entered the following order:

Selma W. Samols, attorney of record, for plaintiff.

James F. Merow, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, NICHOLS and KASHIWA, *Judges.*

"This case comes before the court on defendant's motion to dismiss for lack of jurisdiction of the alleged claim. The motion was considered together with plaintiff's response thereto, without oral argument.

"In the instant case plaintiff, a former Internal Revenue Service employee, is seeking to have a form (SF 50) in his personnel file changed to reflect a voluntary resignation rather than a resignation under threat of termination. Plaintiff's sole request is to have the change made. He does not seek any monetary relief.

"Plaintiff's petition confirms that plaintiff's resignation was voluntary. Accordingly, plaintiff pleads no monetary claim against the United States and could not plead a monetary claim against the United States. *Dounias* v. *United States,* 209 Ct. Cl. 688 (1976). Accordingly, as plaintiff has no monetary claim against the United States in the facts pleaded, this court has no jurisdiction to grant the equitable relief sought and the petition must be dismissed. *United States* v. *King,* 395 U.S. 1 (1969).

"Plaintiff argues that Public Law 92–415, enacted in 1972, granted this court jurisdiction to issue orders directing the '* * * correction of applicable records, * * *.' 28 U.S.C. §1491 (Supp. V, 1975). However, plaintiff fails to note that this jurisdiction was given only as '* * * an incident of and collateral to any such (money) judgment.'

28 U.S.C. § 1491. The authority to order the correction of records thus applies only to cases already within the Court of Claims' jurisdiction, i.e., claims for a money judgment. Public Law 92–415 did not extend the class of cases over which this court has jurisdiction. *United States* v. *Testan*, 424 U. S. 392, 404 (1976). Therefore,

"IT IS ORDERED that defendant's motion to dismiss for lack of jurisdiction is allowed. Plaintiff's petition is dismissed."

No. 347–76. SEPTEMBER 30, 1977

Lakeview Lumber Products Company

Contracts; administrative remedies; exhaustion of administrative remedies; finality of contracting officer's decision; sufficiency of notice of appeal.—On September 30, 1977 the court entered the following order:

Daniel J. Seifer, attorney of record, for plaintiff. *Elizabeth Yeats* and *Kobin & Meyer*, of counsel.

Gerald L. Schrader, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This case comes before the court on defendant's motion for partial summary judgment to bar the prosecution of plaintiff's claim on the ground that plaintiff failed to file a timely administrative appeal from the forest supervisor's decision.

"Plaintiff, Lakeview Lumber Products Company, was awarded a timber sales contract by the U. S. Department of Agriculture, Forest Service. The disputes clause of that contract, Standard Provision B9.2, provided that if the parties to the contract were unable to reach an agreement on a question of fact, the decision of the Forest Service was to prevail within the limitations of law, 41 U.S.C. §§ 321, 322 (1970), and was to be subject to the appellate regulations of the Secretary of Agriculture, 36 C.F.R. §§ 211.20 *et seq.* The applicable regulations provide that any person adversely affected by a forest supervisor's decision relating to a dispute arising under the contract has 30 days

from receipt of that decision to file a written notice of appeal with the forest supervisor. 36 C.F.R. §§ 211.20(a), 211.21(a), 211.30(a).

"In the instant case a dispute arose under the plaintiff's timber sales contract due to a change in rock source from the Drum Hill Pit to Shoestring Pit. The plaintiff filed a claim for adjustment of its contract with the Forest Service on November 4, 1974. Plaintiff claimed direct damages incurred by its subcontractor due to increased costs that resulted from having to disassemble the rock crushing equipment at the Drum Hill Pit, transport it to Shoestring Pit, and reassemble it there. Plaintiff also claimed indirect damages for the lost production incurred by its subcontractor during the time the crushing equipment was not usable due to the unsuitable conditions at Drum Hill Pit and due to the move to Shoestring Pit.

"On February 22, 1975, a preliminary meeting was held to discuss plaintiff's claim. At that meeting the Forest Service officials and the plaintiff seemed to agree that plaintiff's claim involved two separate types of claims which should be handled separately. Also, the forest supervisor seemed to have expressed doubt as to his own authority to rule on the claim for lost production.[1]

"On March 12, 1975, the forest supervisor granted plaintiff's claim for direct damages by issuing, with a transmittal letter, certain contract documents reflecting changes to the timber sales contract.[2] The transmittal letter was completely silent on plaintiff's claim for indirect damages arising from the lost production.[3] This silence coupled with the events which seemed to have transpired during the February 22, 1975, meeting led plaintiff's attorney to seek clarification of the March 12 decision. On March 21, 1975, plaintiff's attorney sent a letter to the Forest Service Regional Counsel seeking such clarification. The Forest Service Regional Counsel's office responded on April 4, 1975, that the March 12, 1975, forest supervisor's

[1] Affidavit of attorney Netzorg, p. 4.

[2] One of the contract documents was revised and reissued on March 18, 1975.

[3] See paragraph three of exhibit A, plaintiff's brief in opposition to the motion for summary judgment, proving that the silence was intentional on the part of the forest supervisor.

decision was a complete decision on plaintiff's claim and appeal was available if the plaintiff was unsatisfied with the entire decision or any part thereof. The plaintiff's attorney filed a notice of appeal on April 25, 1975.

"In its motion for summary judgment, the defendant contends that the March 12, 1975, forest supervisor's decision decided all the plaintiff's claims. Since plaintiff did not file a notice of appeal within 30 days of that decision, as required by the administrative regulations in effect, the forest supervisor's decision has become final.

"A contracting officer's decision must be final before it can be administratively appealed. *Wittenmeier Machinery Co.*, ASBCA 2146, 6 CCF 61757 (1955). This court has stated that

> * * * if the contracting officer's decision is to be accorded finality it should be unequivocal and clear enough to apprise plaintiff of whether it was based on a question of fact or law so that plaintiff can reasonably determine whether an appeal is warranted. * * * [*Allied Contractors, Inc.* v. *United States*, 129 Ct. Cl. 400, 407; 124 F. Supp. 366, 370 (1954).]

An ambiguous decision of a contracting officer need not be appealed, as it cannot be considered final. *Id.;* MCBRIDE, WACHTEL, AND TOUHEY, GOVERNMENT CONTRACTS, § 6.80[7] (1976). Further, an appeal which raises issues or asserts claims which were not decided by the contracting officer must be dismissed as premature. MCBRIDE, WACHTEL, AND TOUHEY, GOVERNMENT CONTRACTS, § 6.80[8] (1976).

"The forest supervisor's letter of March 12, 1975, meets the requirements for finality in regard to plaintiff's claim for direct damages. It was completely silent as to plaintiff's claim for indirect damages arising from the lost production. This silence coupled with the events which seemed to have transpired at the February 22, 1975, meeting could quite naturally have left the plaintiff confused as to the status of the claim for indirect damages. The fact that plaintiff sought clarification of the March 12 letter on March 21 further indicates that the March 12, 1975, letter was not sufficiently clear on the claim for indirect damages to be a final decision. Therefore, plaintiff quite properly sought clarification of the status of the claim for indirect

damages. Upon receiving clarification on April 4, 1975, plaintiff did file final notice of appeal on April 25, 1975, well within 30 days required by the administrative regulations.

"Defendant further contends that, even if the forest supervisor's decision of March 12, 1975, were not granted finality as to the claim for indirect damages until April 4, 1975, the notice of appeal filed on April 25, 1975, is invalid because attorney Netzorg was not authorized to file the appeal for the plaintiff. Defendant points to a May 1, 1975, letter from the plaintiff to Mr. Netzorg, rebuking him for filing the appeal, as clear proof of the lack of authorization. The forest supervisor also filed an affidavit stating that the plaintiff had informed him in a telephone conversation that no appeal would be taken from the March 12, 1975, decision.

"However, attorney Netzorg has filed an affidavit stating that at all times prior to May 1, 1975, he believed himself to be acting for both the plaintiff and the plaintiff's subcontractor in this case. Further, that on May 1, 1975, when he had reason to believe he did not have authority, he withdrew from the case and notified the parties of his withdrawal. There is no evidence that the appeal filed by attorney Netzorg prior to May 1, 1975, was ever renounced, by any of the parties he formerly represented, in a communication directly with the Forest Service.

"Because of the unclear nature of the events which transpired at the February 22, 1975, meeting, the apparent ambiguity in the March 12, 1975, forest supervisor's decision as to the claim for indirect damages, and the dispute over the material issue of whether Mr. Netzorg was authorized to act for the plaintiff in filing the April 25, 1975, notice of appeal, we do not feel granting of the defendant's motion would be appropriate in this case. Therefore,

"IT IS ORDERED that the defendant's motion for partial summary judgment to bar the prosecution of plaintiff's claim be and is hereby denied and that the case is remanded to the trial division."

No. 442-76. SEPTEMBER 30, 1977

James E. McFadden, Inc.

Contracts; termination; solicitation cancellation; contracting officer's discretion; termination for convenience of Government; measure of damages; claim of bad faith.—On September 30, 1977 the court entered the following order (amended pursuant to order entered November 25, 1977):

Herman M. Barenbaum, attorney of record, for plaintiff. *Barenbaum & Barenbaum* and *Ethel S. Barenbaum,* of counsel.

Susan M. Linden, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant. *William P. Bennett,* of counsel.

Before DAVIS, *Judge,* Presiding, NICHOLS and KASHIWA, *Judges.*

"This case for breach of contract comes before the court on defendant's motion for summary judgment. On the basis of the briefs and other submissions, without oral argument,[1] we grant summary judgment to the defendant.

"Plaintiff is a contractor which submitted a bid to the U.S. Postal Service, in the amount of $389,000.00, in response to a solicitation for the rehabilitation of the third floor of the General Post Office in Philadelphia, Pennsylvania. Upon protest by the plaintiff, the two lower bids were declared nonresponsive. The lowest bid of $333,000.00 by I. Lazar & Sons, Inc., lacked a list of proposed subcontractors required by the invitation for bids; the second lowest bid of $376,361.00 by Fluidics, Inc., lacked both the list of proposed subcontractors and the required Philadelphia Plan EEO Goals Certificate. The plaintiff was notified orally on December 15, 1975 by the contracting officer of the award of the contract and received written notice on December 17, 1975.

"On that same day the contracting officer was instructed by his superiors to reject all the responsive bids as unreasonable, since the lowest responsive bid (plaintiff's) was 13% above the Postal Service estimate of $343,147.00

[1] Plaintiff has specifically requested oral argument but we do not consider it necessary or appropriate.

for the project. That afternoon the contracting officer, not realizing that a contract had already been consummated, sent plaintiff a telegram stating that the contract documents should be disregarded since the solicitation had been cancelled and was being readvertised. On December 23, 1975 the plaintiff sent a telegram to the contracting officer protesting the proposed cancellation of the solicitation and the readvertisement of the contract on the ground that a contract had already been awarded to the plaintiff. On that same day the contracting officer sent plaintiff a formal letter terminating the plaintiff's contract for the convenience of the Postal Service.[2] The effective date of the contract termination was December 17, 1975, the same day as the cancellation of the solicitation.

"The plaintiff protested the decision to cancel and readvertise. The Associate General Counsel of the Postal Service decided that the notice of the award created a binding contract, but that the contract was properly terminated. *James E. McFadden, Inc.*, P.S. Protest No. 75–91 (January 13, 1976). A second solicitation was made; the specifications were virtually identical, except that the submission of a list of proposed subcontractors was not required. I. Lazar & Sons, Inc., was the low bidder and was awarded the contract for $344,000.00.

"The plaintiff filed its petition here on October 27, 1976, alleging that the entire termination action was an abuse of discretion and done in bad faith. The Government has moved for summary judgment, asserting that on the undisputed facts the plaintiff has no case. Plaintiff urges that we remand to the Trial Division for a trial.

"We see no need for a trial on the questions raised by plaintiff. One issue is whether the contracting officer abdicated his discretionary authority by following the instructions of his superiors. The defendant in its motion for summary judgment argued that there was no such abdication by the contracting officer, but that upon being

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[2] The termination provision (Clause 40B of PS Form 7391 (May 1975)) provides in part that 'The performance of work under this contract may be terminated by the Postal Service in accordance with this clause in whole, or from time to time in part, whenever the Contracting Officer shall determine that such termination is in the best interest of the Postal Service.'

informed that the Postal Service did not wish to spend so much on the work, the contracting officer exercised his own discretion in deciding that it would be to the best interests of the Government to terminate the contract. However, the defendant, in its Reply to Plaintiff's Answer [Opposition] to Defendant's Motion for Summary Judgment, takes a somewhat different tack and admits the 'substance' of plaintiff's allegation that the contract had been cancelled by the contracting officer 'on direction from higher authority that the McFadden bid exceeded the government estimate, which was $343,147.00, by more than ten percent.' The telegram from Washington to the Philadelphia office reads in pertinent part:

> To confirm our telecon this date you will reject all bids for IFB No. R–76–001 for demolition and rehabilitation. Rejection is to be based on PCM 2–404.1 B–(VI) 'All otherwise acceptable bids received are at unreasonable prices'. The government estimate was $343,147 for this work and the lowest responsible bid was $389,000. An increase of 13% above the government estimate.
>
> You are further requested to immediately readvertise the project for a shorter bid period deleting the requirement for a subcontractor list in its entirety.

The defendant's contention (in its Reply) is that, although the contracting officer was thus told to reject all bids and readvertise, he exercised his own discretion in deciding to implement that order by terminating the contract for convenience. We need not, however, determine whether that position is sound or whether the superior's language was so peremptory as necessarily to imply that the contracting officer did in fact abdicate his discretionary role with respect to the termination (or that the defendant has made such a concession). *Cf. Pacific Architects & Engineers Inc. v. United States*, 203 Ct. Cl. 499, 518–20, 491 F.2d 734, 745–46 (1974). Even if it were to be assumed *arguendo* that the contracting officer did abdicate his discretionary authority and terminate the contract under orders from his superiors, the plaintiff would not be entitled to the anticipatory profits sought here, but only to the measure of relief provided under a termination for

convenience. In *Schlesinger v. United States*, 182 Ct. Cl. 571, 390 F.2d 702 (1968), the Navy under pressure from Congress terminated the plaintiff's contract for default. The court held that the default termination was invalid because the Navy had abdicated its discretionary authority. However, because of the presence of the termination-for-convenience clause the court did not treat such an improper termination as a breach of contract calling for anticipatory damages. *Schlesinger, supra*, 182 Ct. Cl. at 584–85, 390 F.2d at 709–10; *John Reiner & Co. v. United States*, 163 Ct. Cl. 381, 389–92, 325 F.2d 438, 442–44 (1963), *cert. denied*, 377 U.S. 931 (1964). Given the presence of the termination-for-convenience clause the contract could have been terminated at any time; as a result, the plaintiff would be unable to provide the 'clear and direct proof' that it would have made the claimed anticipatory profits, which is necessary in order to recover such profits. *Nolan Bros., Inc. v. United States*, 186 Ct. Cl. 602, 610, 405 F.2d 1250, 1255 (1969); *John Reiner & Co., supra*, 163 Ct. Cl. at 393–94, 325 F.2d at 444–45.

"Aside from its argument on abdication of discretionary authority, the plaintiff contends vigorously that the contracting officer acted in bad faith, and points to the meanings of 'commercial reasonableness' and 'good faith' in dealings between private parties. But it is clear from the facts that neither the contracting officer nor his superiors acted in 'bad faith,' as defined by this court in connection with the actions of government officials on termination. In *Kalvar Corp. v. United States*, 211 Ct. Cl. 192, 199, 543 F.2d 1298, 1302 (1976), *petition for cert. filed*, 45 U.S.L.W. 3808 (June 6, 1977) (No. 76–1732), the court examined in detail the nature of such 'bad faith' and equated it with a 'specific intent to injure the plaintiff.' The plaintiff in its petition and its briefs alleges no facts from which such intent, which must be shown with 'well-nigh irrefragable proof,' could be inferred. *Knotts v. United States*, 128 Ct. Cl. 489, 492, 121 F. Supp. 630, 631 (1954). In *Colonial Metals Co. v. United States*, 204 Ct. Cl. 320, 331, 494 F.2d 1355, 1361 (1974) it was held that the contracting officer, who had terminated the contract in order to purchase a supply of copper at a lower price elsewhere, did not act in bad faith

even though he knew at the time of the award of the original contract that the copper was available at a lower price. The motivation of the contracting officer's superiors in the instant case was identical, a desire to obtain a lower price. Even if we assume that the contracting officer abdicated his own discretion in following his superiors' instructions to cancel the solicitation, on the facts of the case there was no abuse of discretion by the Postal Service, tantamount to "bad faith." In the absence of malicious intent or animus toward the plaintiff on the part of the government officials, the plaintiff is entitled only to the compensation provided under the termination-for-convenience clause.[3]

"IT IS THEREFORE ORDERED AND CONCLUDED that the defendant's motion for summary judgment is granted on plaintiff's claim that the contract was terminated because of bad faith and that the plaintiff is not entitled to recovery other than that provided in its convenience-termination clause. The case is dismissed, without prejudice to plaintiff's right to file another petition at a later date seeking review of the administrative determination as to the amount of termination costs to which it is entitled under the terms of the contract."

No. 551–76. SEPTEMBER 30, 1977

Douglas E. Dillon

Military pay; discharge; erroneous enlistment; medical fitness standards; right to remain in service.—On September 30, 1977 the court entered the following order:

Douglas E. Dillon, *pro se.*

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[3] The plaintiff has furnished nothing from which there could be inferred any malice or animus against it, or any governmental intent to injure it. It is absolutely plain that the Postal Service's desire was simply to save money if possible, by having the contract readvertised. In contrast, see the order of September 30, 1977 in *Allied Materials & Equipment Inc. v. United States*, Ct. Cl. No. 342–75, in which the court found sufficient possibility of such bad faith, in the facts already before it, to order a trial of the issue, *ante* at 902.

Marc J. Fink, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This case is before the court, without oral argument, on defendant's motion for summary judgment. Upon review of the parties' submissions, we find that there are no material facts in dispute and that defendant is entitled to judgment as a matter of law.

"Plaintiff was honorably discharged from the United States Marine Corps in April 1976, shortly after he reported to Parris Island for recruit training. Three years prior to his enlistment, plaintiff broke his neck and underwent extensive surgery to fuse the affected vertebrae. Plaintiff fully apprised the Corps of his injury, the surgery performed and the extent of his recovery.[1] In September 1975, plaintiff received from the Corps a Certificate of Acceptance in the Reserves stating, *inter alia*, that he had 'successfully passed the required mental, moral and physical examinations and had been accepted . . .' Plaintiff thereafter joined the regular Corps and reported for training to Parris Island. At his entry screening examination he was initially found physically fit to undergo military training, but because of his neck condition was shortly referred to a Navy orthopedic clinic for further evaluation of that injury. The clinic's physician then recommended consideration of plaintiff's case by a board of medical officers and the board ultimately recommended discharge due to an erroneous enlistment. This was effected.

"Plaintiff contests his separation on two grounds. His first argument is that the discharge violated his enlistment contract. It is well established, however, that in circumstances such as these a serviceman does not have a contractual right to remain in the service until his enlistment term expires (*see, e.g., Keef v. United States*, 185

[1] Plaintiff recovered to the extent that he was able to compete quite successfully as a high school wrestler but his own doctors recommended that he not engage in contact sports 'like football.'

Ct. Cl. 454, 463–64 (1968)), and that the validity of a discharge depends on the relevant legislation and regulations, not on the principles of contract law. *See, e.g., Abbott v. United States*, 200 Ct. Cl. 384, 388–89, *cert. denied*, 414 U.S. 1024 (1973). Proper administrative separation and discharge, therefore, terminate an enlistment contract and end any entitlement to pay or other in-service benefits.

"The remaining issue is whether plaintiff's separation and discharge were, as he alleges, arbitrary and capricious or, as defendant contends, in full accord with statute and the Marine Corps' policy and procedure. The Corps' Separation and Retirement Manual (promulgated pursuant to 10 U.S.C. § 1169) states in subparagraph 6012.1e that the Commandant of the Marine Corps may authorize a serviceman's release for, among other reasons, 'erroneous enlistment,' if a medical board establishes that a recruit failed to meet the required physical standards when accepted for enlistment. This discretionary authority is designed to permit the Government to avoid future liability resulting from potential aggravation of a serviceman's preexisting injury or disease. In plaintiff's case, he had been assured that his injury would not preclude his full participation in the Marine Corps. These assurances, however, cannot be used to estop the Government from making and acting upon a procedurally correct reevaluation of his medical condition. *See Gatson v. United States*, 211 Ct.Cl. 303 (1976).

"We have reviewed the regulations and plaintiff's contentions and find that here the correct procedures were followed. Plaintiff was not, as he alleges, entitled to a trial-type hearing before the medical board and his bare allegation that he was coerced to waive his right to a written rebuttal of the board's findings does not raise a triable issue. Plaintiff does not offer anything to substantiate his charge that the Government used improper separation forms. He did not have the right, under the regulations, to the form he contends should have been used as that form applies only to a discharge for disability incurred in or aggravated by service activities. Defendant's documents (which include plaintiff's discharge papers) clearly indicate that plaintiff was honorably discharged for

erroneous enlistment based on his undisputed physical injury and no reasonable inference adverse to plaintiff's interests can be drawn from these papers. As for the medical foundation for the Corps' conclusion that he should not have been accepted for duty, again plaintiff does not raise any triable issue that the decision was arbitrary, capricious, or unsupported by substantial evidence. He unquestionably had a serious neck injury, including wiring of the vertebrae, and even though he can apparently carry on his wrestling activities it is impossible for us to hold that the Marine Corps was barred from rejecting him for its demanding service.

"In summary, we find that, despite plaintiff's contention that he is fit to serve as a United States Marine, the Corps properly acted within its authority to decide otherwise. The materials in the record, viewed in the light most favorable to the plaintiff, cannot be interpreted to show that the Marine Corps acted in an arbitrary or capricious manner in violation of his rights. Accordingly, on consideration of the petition, the defendant's motion for summary judgment, plaintiff's reply, and the various exhibits, IT IS ORDERED that defendant's motion is granted and the petition is dismissed.[2]"

No. 289–76. SEPTEMBER 30, 1977

Ewing M. Kauffman and
Muriel I. Kauffman

Taxes; income tax; deductions; depreciation; baseball players' contracts; collateral estoppel; summary judgment

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[2] Belatedly, plaintiff has moved (1) to amend his petition to ask for $5,000,000 in damages, and (2) for a writ of mandamus to have the Department of Defense convene a military court of inquiry regarding certain alleged violations of the Uniform Code of Military Justice. These matters are obviously beyond the jurisdiction of this court, and the motions are therefore denied. Damages here would have to be limited at most to back pay as a private, while the requested sum of $5,000,000 clearly includes an overwhelming segment for tort damages which this court cannot award. Similarly, we have no power to order the Defense Department to convene a military court of the type plaintiff requests.

The court has also considered the other arguments and material contained in plaintiff's written submissions (including those received on August 31, 1977 and September 12, 1977) and finds that none of them calls for a result other than dismissal of the petition.

inappropriate.—On September 30, 1977 the court entered the following order:

R. Eugene McGannon, attorney of record, for plaintiffs. *Hoskins, King, McGannon, Hahn & Hurwitz, Walter J. Kennedy* and *Philip J. Erbacher,* of counsel.

Gilbert W. Rubloff, with whom was *Assistant Attorney General M. Carr Ferguson,* for defendant.

Before DAVIS, *Judge,* Presiding, NICHOLS and KASHIWA, *Judges.*

"This case comes before the court, without oral argument, on plaintiff's motion for partial summary judgment. Plaintiff Ewing M. Kauffman (taxpayer) is the sole shareholder of the Kansas City Royals Baseball Corporation. For the fiscal year ended October 31, 1971, the corporation elected Subchapter S treatment pursuant to section 1372 of the Code. Taxpayer was thus entitled to deduct the corporation's net operating loss for 1971 on his personal income tax return for that year. I.R.C. § 1374. The source of present controversy involves the allocation of the costs of forming the corporation in 1968 between the cost of acquiring thirty baseball-player contracts from existing member clubs and the cost of acquiring a franchise with the American League. Since the former cost is considered for present purposes to be depreciable and the latter cost not,[1] the value given the player contracts can determine the yearly amortization deduction allowed the corporation and thus the size of its loss in 1971. Taxpayer alleges that the player contracts have a value equal to that ascribed to in the player contracts, or $175,000.00 each, for a total of $5,250,000.00. The Government, in an audit conducted in 1973, determined the value of the player contracts to be $465,000.00, with the remaining $4,785,000.00 allocated as the cost of the franchise. Plaintiff paid the assessment resulting from the lesser depreciation deduction allowed

[1] For the purposes of this motion, it is assumed *arguendo* by both parties that franchise costs are nondepreciable. Taxpayer's motion alleges that the proper valuation for the franchise is equal to the amount stated in the franchise agreement; it does not assert that such sum is depreciable. Plaintiff indicates that it intends to assert in the future that franchise costs are depreciable if such costs are found to be substantially greater than the value assigned them in the agreement. Petition, p. 21.

the corporation for 1971 and now seeks refund of this amount, a total of $50,290.00 plus interest.

"Plaintiff's motion asserts that, as a matter of law, the value of the player contracts must be taken in this case as equal to the value ascribed to them in the club's agreement with the American League. The argument is twofold. First the Government is alleged to be collaterally estopped or precluded from asserting a different valuation because of this court's decision in *Baltimore Baseball Club, Inc. v. United States,* 202 Ct. Cl. 481, 481 F.2d 1283 (1973). Secondly, the Internal Revenue Commissioner's acceptance of the corporation's valuation of the player contracts in an audit of its earlier, 1968 tax return is alleged to estop the Government in its present suit.

"The court's decision in *Baltimore Baseball* did not, however, hold that the contractual valuation of the player contracts purchased by that plaintiff was correct. Neither the amount nor the character of the gain was in dispute in *Baltimore Baseball;* rather, the issue involved the tax year in which the gain was to be recognized. For that question it was immaterial whether the income realized represented proceeds from the disposition of player contracts or the sale of other non-realty capital assets. In either instance, the proceeds would have been taxed as long term capital gains, and the appropriate tax year would have been determined by the applicability, vel non, of section 453 of the Code ("Installment Method").[2] The court's opinion did not determine the value of the player contracts because that sum was not at all in issue.

"Under these circumstances, the Government is not collaterally estopped or precluded from now disputing the value of the present taxpayer's player contracts. Before that principle may be asserted, the particular issue must be controverted in the previous case and the determination of the issue must have been essential to the finding or verdict rendered. *Commissioner v. Sunnen,* 333 U.S. 591, 598 (1948). Where, as here, the claim sued upon necessarily differs from the earlier claim, a party is free to litigate

[2] A second issue, regarding the asserted applicability of the 'recovery of cost' method of reporting gain, Treas. Reg. § 1.453–6, was easily dismissed by the court. *Baltimore Baseball,* 202 Ct. Cl. at 493–95, 481 F.2d at 1290–91.

points which were not at issue in the first proceeding, even though those issues might have been tendered and decided at that time. *Id.*; A.L.I., RESTATEMENT OF THE LAW SECOND, JUDGMENTS, §§ 45(c), 68 (Tent. Draft No. 1, 1973).[3]

"Similarly, the Government is not estopped by the acceptance by the Revenue Service of the asserted valuation of player contracts in an audit for an earlier year. *Automobile Club v. Commissioner*, 353 U.S. 180, 183–84 (1956); *Easter v. Commissioner*, 338 F.2d 968, 969–70 (4th Cir. 1964), *cert. denied*, 381 U.S. 912; *see Caldwell v. Commissioner*, 202 F.2d 112, 115 (2d Cir. 1953); *Harry Fogel*, T.C. Mem. 1957–228.

"Failing on both grounds he puts forward for resolving as a matter of law the value of the player contracts, taxpayer has not met his burden of showing that there is no genuine issue of material fact. *Joseph Horne Co. v. United States*, 133 Ct. Cl. 270, 135 F. Supp. 549 (1955).

"IT IS THEREFORE ORDERED AND CONCLUDED that plaintiffs' motion for partial summary judgment is denied and the case is returned to the Trial Division."

No. 188–75. OCTOBER 11, 1977

General Electric Company

Pleading and practice; disqualification of counsel; disqualification of trial judge.—On October 11, 1977 the court entered the following order:

Irving M. Freedman, attorney of record, for plaintiff. *Ronald R. Snider and Sughrue, Rothwell, Mion, Zinn & Macpeak*, of counsel.

Steven Kreiss, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant. *Thomas J. Byrnes* and *Vito J. DiPietro*, of counsel.

John S. Munday, attorney of record, for third party defendant Honeywell, Inc. *Jon O. Nelson, Allegretti, Newitt, Witcoff & McAndrews, Andrew E. Taylor*, and *Larson, Taylor & Hinds*, of counsel.

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[3] This disposition of the question of collateral estoppel or issue preclusion makes unnecessary any determination of whether "mutuality of estoppel" is still a prerequisite to assertion of that doctrine in circumstances like those present here.

Before DAVIS, *Judge*, Presiding, KASHIWA and BENNETT, *Judges*.

"This matter comes before the court without oral argument, on plaintiff General Electric's request for review, under Rule 53, of the order (of September 13, 1977) of Trial Judge Browne disqualifying plaintiff's attorney, Ronald R. Snider, from participating on behalf of plaintiff in the scheduled trial of this patent case.

"Until December 1976 Mr. Snider was an attorney in the Patent Section of the Civil Division of the Department of Justice. As such, he represented the United States in another, unrelated patent suit (involving another patent and other issues) brought by plaintiff General Electric in this court against the Government, No. 81–70, petition dismissed, *ante* at 636. He also represented the United States in a separate patent action, *Gould v. United States*, Ct. Cl. No. 429–74, which involved 'on sale' issues either 'substantially identical' (in third-party Honeywell's words) or 'similar' (the Government's phraseology) to the 'on sale' issue to be tried and determined in the present suit by General Electric. Mr. Snider and his present firm (Sughrue, Rothwell, Mion, Zinn & Macpeak) were retained in July 1977 by plaintiff to represent it in the trial of this case (then scheduled for mid-September 1977).

"On September 2, 1977, third-party defendant Honeywell moved to disqualify Mr. Snider and the Sughrue firm. The defendant, though not itself moving, supported that motion. On September 13, 1977, Trial Judge Browne issued his order disqualifying Mr. Snider, but not other personnel of the Sughrue firm. The Trial Judge certified the matter for prompt review under Rule 53(c)(2)(i), and this request for review was filed by General Electric on September 16, 1977. Both defendant and Honeywell have opposed the request. Meanwhile this panel of the court stayed the trial for a period of sixty days. Order of September 14, 1977.

"There is some suggestion by the Government in its correspondence with Mr. Snider (furnished to the court on this request for review) that Mr. Snider, while at the Justice Department, actually discussed some aspects of the present case, particularly the 'on sale' defense as applied to this case, with Mr. Kreiss, defendant's counsel in this case.

Mr. Snider denies this categorically and states that his only discussion of or work on the 'on sale' defense were with respect to the *Gould* case, *supra*. In the present posture of this disqualification matter, the court accepts Mr. Snider's representation. The Trial Judge's 'Memorandum of Opinion and Decision on Motion for Disqualification of Counsel for Plaintiff' makes clear (pp. 3–4) that, as to Mr. Snider, the disqualification order was *not* based on the possibility that this *General Electric* case was directly discussed by Mr. Snider while employed at the Justice Department, but solely on (a) Mr. Snider's having represented the Government in the other patent case involving *General Electric*, and (b) Mr. Snider's having discussed with his then government colleagues the 'on sale' issue involved in *Gould*, *supra*, which issue is similar to an issue in the present case.

"We do not consider either of the grounds advanced by the Trial Judge as warranting the court's disqualification of Mr. Snider, and we are aware of no decision or ruling calling for his disqualification. First, no violation of a statute or governmental regulation has been shown. The Justice Department said in its letter of August 29, 1977 to Mr. Snider that 'we do not believe that your disqualification is compelled by any statute or regulation * * *.'[1] We agree. Section 207 of Title 18 of the U.S. Code—dealing with 'disqualification of former officers and employees in matters connected with former duties or official responsibilities'—disqualifies only persons who 'participated personally and substantially as a [government] officer or employee' in the suit, 'particular matter,' etc., now before the court or tribunal (subsection (a)), or had the suit, 'particular matter,' etc. 'under his official responsibility as an officer or employee of the Government' (subsection (b)). Mr. Snider falls into neither class. As this request for review comes to us, it cannot be said that he participated at all in *this General Electric* case, or that he had it in any way under his official responsibility. With respect to his consideration of the 'on sale' defense in connection with his participation in *Gould*, the studying of, discussion about,

[1] The letter went on to say that, 'to avoid any appearance of impropriety,' Mr. Snider should voluntarily remove himself.

and application of a general legal issue in a wholly different case is not a 'particular matter' within § 207 (nor does it fall under any other term specified in that section).

"Second, as the matter comes to us we find no violation by Mr. Snider of any part of the Code of Professional Responsibility. Canon 4 ('A Lawyer Should Preserve the Confidences and Secrets of a Client') is inapplicable because there is no reason at all to believe that Mr. Snider received any government confidences or secrets applicable to the present *General Electric* case; certainly, learning about the law of an 'on sale' defense to the validity of a patent (which he may have acquired by his connection with the *Gould* case) is not a governmental confidence or secret. Likewise no bar to Mr. Snider's employment is Canon 5 ('A Lawyer Should Exercise Independent Professional Judgment On Behalf of a Client'). Again, there is no reason to believe that, because Mr. Snider represented the defendant in the other, separate *General Electric* case, he cannot properly represent *General Electric* in the present case which involves different issues and a different patent. General Electric is not complaining, and we do not see how its interests will be injured. It is far from uncommon for former government lawyers to represent, in private practice, companies or individuals whom they opposed on other matters while in the Government. As for the 'on sale' defense which emerged in *Gould* and is also involved here, so long as General Electric is satisfied with Mr. Snider we do not consider that we can say that any embarrassment he may possibly entertain in acting for his current client with respect to the application of that general defense to the particular facts of this case mounts to a violation of the Canon.

"Finally, Canon 9 ('A Lawyer Should Avoid Even the Appearance of Professional Impropriety') has been invoked. In particular, reliance is placed on Ethical Consideration 9–3 and Disciplinary Rule 9–101(B), declaring that former public employees and officials should not accept private employment in any matter in which they had 'substantial responsibility' while in public service. Our discussion *supra* of 18 U.S.C. § 207 shows that Mr. Snider,

as a government lawyer, did not have 'substantial responsibility' for this suit or for any matter involved in it.[2] Nor does 'substantial responsibility' characterize his connection with the 'on sale' issue in *Gould*. Just as with the statute, we do not understand the Canon or its subordinate parts to cover ex-government lawyers who have worked on general legal issues while in service, and thereafter use that legal expertise in behalf of private clients. To extend the Canon to that extreme would needlessly destroy the 'interchange between the private and public sectors of the bar' (*Kesselhaut v. United States, supra,* 214 Ct. Cl. at 129, 555 F.2d at 793–94.

"As we have indicated, Trial Judge Browne did not disqualify other personnel of the Sughrue firm although he was asked to do so, by Honeywell and the Government, for the independent reason that, a decade ago, the Sughrue firm had given an opinion suggesting that the patent in suit was invalid. The Trial Judge refused this aspect of the disqualification motion with some misgivings and added that he gave 'no promise that by so doing [*i.e.,* permitting the Sughrue firm to continue to represent General Electric in this suit] I will exclude the possibility, in the event of a ruling of invalidity of the patent, of entertaining a motion for award of attorney's fees against the plaintiff for having asserted a knowingly invalid patent' (Memorandum of Opinion and Decision, etc., p. 5). Neither Honeywell nor the Government has sought interlocutory review of this part of the order, and it is clear that the decisions not to do so were deliberate.

"Nevertheless, both defendant and third party defendant now ask the court, *sua sponte,* to disqualify the entire Sughrue firm on this independent ground. We reject the suggestion to consider this matter. Where the parties have deliberately chosen not to seek review of a disqualification claim which is far from perfectly plain on its face and which the Trial Judge has refused to accept, the court will not intervene on its own motion. We do not consider the

[2] The attorney involved in *Kesselhaut v. United States,* 214 Ct. Cl. 124, 555 F.2d 791 (1977), had some personal participation in the matter there involved, and likewise held the very different post of general counsel of his agency. Mr. Snider did not have any supervisory role.

claimed disqualification of the entire Sughrue firm to be clear as a pikestaff, and therefore, absent a request for review, leave the Trial Judge's decision (together with its caution to the Sughrue firm) with neither confirmation nor rejection.

"Similarly, we reject plaintiff's belated invitation (in its reply to its opponents' responses) to the court *sua sponte* to disqualify Trial Judge Browne because of the position he took on the possibility of an award of attorneys' fees against plaintiff if the patent were to be held invalid. Plaintiff did not request review of the Trial Judge's order on this ground nor did it ask us, in its request for review, to disqualify Trial Judge Browne. If any proceedings for such disqualification are to be further pressed, the plaintiff's attention is called to Rule 14(d).

"IT IS THEREFORE ORDERED AND CONCLUDED that the plaintiff's request for review is granted and the Trial Judge's order of September 13, 1977, disqualifying Ronald R. Snider, is vacated and reversed insofar as review has been sought of that order."

No. 51-71. OCTOBER 21, 1977

Codell Construction Co., et al.

Contracts; breach claim; Spearin rule of implied warranty re Government specifications and drawings.—Plaintiff seeks damages for alleged breach of a contract for construction of the second stage of the six-stage Fishtrap Reservoir Project on the Big Sandy River in Pike County, Kentucky. Completion of plaintiff's portion was set for June 29, 1968, performance to occur during four construction seasons. The first-stage contract awarded to another was for building a tunnel through an adjoining hillside, foundations of the intake structure to the tunnel allowing controlled flow of water to bypass the dam, and the tunnel outlet. The first-stage work was scheduled to be completed prior to July 1, 1965, and it was intended that the river should then be diverted by a cofferdam to pass through the tunnel while the dam was being built across the original channel. Plaintiff's contract related to the construction of the intake structure with hydraulically operated slide

gates, sluice liners, trashracks, elevator and heating and water systems. The invitation for bids contained drawings showing a six-step water diversion procedure for construction of the intake structure in the dry. Plaintiff experienced delays occasioned by unusually high water flow and flooding. Plaintiff's administrative claim for an equitable adjustment was denied. Plaintiff claims here that it was required to follow the six-step diversion plan and that the Government misled it into believing that if it did follow that plan it would be able to complete the lower level of the intake structure within approximately 90 days without substantial interference from flooding. Plaintiff contends that whether or not 1966 had unusually high water flow on the river at the damsite, the diversion plan was inadequate even for an average year. On June 23, 1976 Trial Judge Kenneth R. Harkins filed a recommended decision (reported at 24 CCF para. 81,820), setting forth at length his reasons for concluding that there was no breach of contract and that plaintiff is not entitled to recover. On October 21, 1977 the court, by order, adopted the recommended decision as the basis for its judgment in this case, concluded that plaintiff is not entitled to recover and dismissed the petition. Plaintiff's motion for rehearing was denied January 13, 1978.

No. 383-75. OCTOBER 21, 1977

Juliet M. Anton

Military pay; disability retired pay; computation of retired pay.—Plaintiff, a nurse by profession, was formerly on active duty as a regular officer of the Air Force. On February 6, 1974 she was permanently retired by the Air Force in the grade of Lieutenant Colonel because of physical disability, with a compensable rating of 69% and a compensable percentage of 70%. Plaintiff contends, in this action, that at the time of her retirement, her compensable rating should have been increased to 75% (or higher) and her compensable percentage to 75% (the maximum percentage permissible under 10 U.S.C. § 1401). Plaintiff seeks to recover the additional financial benefits which an increase in her compensable percentage would have

entailed. The controversy revolves around (1) what compensable ratings the Air Force should have given plaintiff on the basis of disabling difficulties relating to her feet, to her spine, and to a duodenal ulcer and associated hiatus hernia, and (2) whether the Air Force should have given plaintiff a compensable rating for anxiety neurosis. In a recommended opinion filed January 10, 1977 Trial Judge Mastin G. White concluded that the evidence of record does not constitute the sort of clearly convincing proof that would be required to justify the court in overturning the Air Force's evaluations concerning the extent of plaintiff's disabilities at the time of her permanent retirement, and accordingly plaintiff is not entitled to recover. On October 21, 1977 the court, by order, adopted the recommended decision as the basis for its judgment in this case, concluded and ordered that as a matter of law plaintiff is not entitled to recover, and dismissed the petition.

No. 156–69. OCTOBER 28, 1977

Affiliated Ute Citizens of the
State of Utah, etc.

Indian claims; limitation of actions; accrual of cause of action; water, fishing and hunting rights; rights to future growth of timber; 1961 termination proclamation.—On October 28, 1977 the court entered the following order:

Parker M. Nielson for plaintiffs. *Wallace L. Duncan,* attorney of record.

Glen R. Goodsell, with whom was *Assistant Attorney General James W. Moorman,* for defendant. *James M. Mascelli,* attorney of record.

Before KUNZIG, *Judge,* Presiding, LARAMORE, *Senior Judge,* and BENNETT, *Judge.*

"This case, before the court on cross-motions for summary judgment, presents for resolution issues left undecided in our previous order of October 20, 1972, reported at 199 Ct. Cl. 1004. There we held the statute of limitations, 28 U.S.C. § 2501, barred plaintiffs' claims concerning land, cash, personal assets, oil, gas, and mineral rights, and

unadjudicated and unliquidated claims against the United States. Left open for further factual development were claims concerning water, fishing, and hunting rights, and rights to future growth of timber. The court said that the record before it did not then permit a determination as to whether that class of intangible property had been divided and distributed by the time of the termination proclamation in August 1961.

"The parties have cooperated in formulating a stipulation of facts which now permits a disposition of the questions earlier left open. We find nothing in the record to shake our conviction that any acts for which the Federal Government might have been liable occurred by 1961, leaving plaintiffs' 1969 filing untimely. The purpose of the termination act was to end the tribal status of mixed-blood Utes and to convert their status to that of ordinary American citizens. The division and distribution of assets of which plaintiffs complain were effected by 1961, all intangible assets being conveyed either in the form of shares in the Ute Distribution Corporation or as appurtenant to land; whatever claims plaintiffs may have had matured then and became barred by the statute of limitations in 1967. Plaintiffs contend that their rights matured in 1966, when the range corporations were dissolved and certain of their assets were acquired by the tribe. But, whatever rights the mixed-bloods took were fixed in 1961, after which the Federal Government took no actions affecting the parties' division of assets. The later payment of money by the Government to the Ute Distribution Corporation does not affect this conclusion, since the relative shares of that corporation were finally fixed by 1961. Neither do we find merit to plaintiffs' contention that they did not know and could not have known that all assets were being divided by the termination procedures. Defendant's numerous citations to the statute, to pre-termination correspondence, and to the plans for division and distribution, leave us no doubt that the mixed-bloods had notice of the finality of the termination procedures. In short, plaintiffs have pointed to no evidence, and we can find none ourselves, establishing a continued federal responsibility for claimed assets of the

mixed-bloods beyond the time of the termination proclamation.

"Although such a claim was not left open by our 1972 order, plaintiffs also seek compensation for the Government's purported liability for the alleged conflict of interest of the mixed-bloods' attorney during the termination procedures. Even if there were evidence that the attorney had a conflict of interest which injured plaintiffs and for which the Government could be held responsible, the statute of limitations bars this claim too, for the final contract between plaintiffs and the attorney ended more than 6 years before the filing of this suit.

"Plaintiffs also claim entitlement to some of the tribal funds expended on the Uintah Indian Irrigation Project. Again, no federal acts after 1961 can be found which permit plaintiffs to escape the limitations bar.

"Finally, plaintiffs ask that we vacate our 1972 order, claiming that federal acts since then have shown our previous ruling to have been erroneous. We disagree. The facts cited only show the weakness of the contention that federal responsibility for the division of tribal assets continued beyond the termination proclamation in 1961.

"IT IS THEREFORE ORDERED, upon consideration of the motions, briefs, and oral argument, that defendant's motion for summary judgment is granted, that plaintiffs' cross-motion for summary judgment is denied, and that the petition is dismissed."

Plaintiffs' petition for a writ of certiorari was denied May 15, 1978.

No. 11-73. NOVEMBER 11, 1977

Goose Creek Hunting Club, Inc.

Eminent domain; taking; flowage easement; just compensation; rate of interest.—In a decision reported at 207 Ct.Cl. 323, 518 F.2d 579 (1975), the court held that the United States had taken a permanent flowage easement over approximately 110 acres of land owned by plaintiff and that the date of taking was March 28, 1972. On remand to the trial judge for determination of the amount of plaintiff's recovery, a trial was held on the issue of

damages. In a recommended decision filed April 6, 1977, Trial Judge Mastin G. White concluded that prior to the taking plaintiff's land was best suited for recreational use as a hunting area, that the area cannot now be used for hunting, that the fair market value of the land was reduced by $8,250 from the "before taking" value of $111,910 to the "after taking" value of $103,660, and that plaintiff is entitled to recover $8,250, plus an amount computed at the rate of 7–1/2% per annum on $8,250 from March 28, 1972 to the date of payment, plus reasonable costs, disbursements and expenses actually incurred by plaintiff because of the litigation. On November 11, 1977, by order, the court adopted the recommended opinion as the basis for its judgment in this case, ordered that plaintiff is entitled to recover, and entered judgment for plaintiff for $9,551, plus an amount computed at the rate of 7–1/2% per annum on $8,250 from March 28, 1972 to the date of payment.

No. 240–73. NOVEMBER 11, 1977

Atlantic, Gulf & Pacific Company
of Manila, Inc.

Contracts; disputes; convenience-of-Government termination; cost items; general and administrative expenses; profit allowance; application of loss formula; attorney's fees.—In October 1963 plaintiff contracted with the Air Force to rehabilitate 435 family quarters at Clark Air Base in the Philippine Islands. The original contract provided a fixed unit price to aggregate not more than an estimated $1,352,957, later increased to $1,408,009. A formal notice of termination for convenience was issued on August 10, 1966, and because no further work was done after February 15, 1966 the notice implied that the termination would be effective retroactively to that date, which the ASBCA ratified. After termination the parties began negotiating a settlement, plaintiff finally appealing to the ASBCA which considered 59 extra work claims separately from the termination settlement proposal. The board allowed an additional sum in settlement of all of plaintiff's outstanding claims, and from this decision plaintiff appealed certain

unfavorable aspects here. Count 1 of the petition was dismissed by court order reported at 207 Ct.Cl. 995 (1975). On July 15, 1977 Trial Judge C. Murray Bernhardt filed a recommended decision (reported in full at 24 CCF para. 81,821) concluding that the Board's decision passes muster under Wunderlich Act criteria. On November 11, 1977 the court, by order, adopted the recommended decision as the basis for its judgment in this case, concluded and ordered that the conclusions and determinations of the ASBCA are supported by substantial evidence and are legally correct, and that the petition and defendant's counterclaims be dismissed. The court points out that by "such adoption the court does not hold, or intend to hold, that attorney's fees incurred in discussions by a contractor's attorney with the administrative superiors of a contracting officer over the proper amount of a termination settlement—as distinguished from attorneys fee costs incurred in prosecution of a settlement of a claim or appeal under the 'Disputes' clause—are necessarily to be excluded from the termination settlement."

No. 40–74. NOVEMBER 11, 1977

VCA Corporation

Taxes; income tax; corporate distributions and adjustments; merger; carryovers; obligations; deductions allowable.—In a recommended opinion filed July 22, 1977 (reported in full at 40 AFTR 2d 77–5429 and 1977 USTC para. 9554), Trial Judge Philip R. Miller concluded that plaintiff, which acquired two corporations in a merger, was entitled to deduct amounts it paid to the former president of one of the acquired corporations in settlement of a breach of the latter's employment contract. The deduction had been disallowed by the Internal Revenue Service and the assessed deficiency had been paid by plaintiff. On November 11, 1977 the court entered the following order:

Charles W. Davis, attorney of record, for plaintiff. *Michael F. Duhl* and *Hopkins, Sutter, Mulroy, Davis & Cromartie*, of counsel.

Patricia B. Tucker, with whom was *Assistant Attorney General M. Carr Ferguson*, for defendant. *Theodore D. Peyser*, of counsel.

Before DAVIS, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*

"This case comes before the court on plaintiff's motion, filed September 19, 1977, requesting that the court adopt, as the basis for its judgment in this case, the recommended decision of Trial Judge Philip R. Miller, filed July 22, 1977, pursuant to Rule 134(h), defendant on September 13, 1977, having withdrawn its previously filed notice of intention to except. Upon consideration thereof without oral argument, with respect to attorneys fees the court does not adopt the Trial Judge's opinion as its holding or as a precedent, but reserves the general question of attorneys fees in tax cases for resolution in *Aparacor, Inc.* v. *United States*, No. 139–73, to be heard *en banc* in December, 1977. [*See ante* at 596.]

"On the merits of the tax question posed by the case the court adopts the Trial Judge's findings and conclusion, but in view of the complexity of the issues discussed in the Trial Judge's opinion, the court does not feel justified in adopting that opinion *in haec verba* without benefit of full adversary presentation before the court, but does agree that the applicable Treasury Regulations support the plaintiff's claim.

"IT IS THEREFORE CONCLUDED AND ORDERED that the court has jurisdiction of the case and that plaintiff is entitled to judgment for refund of taxes and interest paid. Accordingly, judgment is entered for plaintiff with the amount of recovery to be determined in further proceedings pursuant to Rule 131(c)."

On November 29, 1977 the trial judge filed a memorandum report recommending that, in accordance with the order of the court and the stipulation of the parties, judgment be entered for plaintiff for refund of taxes and assessed interest for its fiscal year ended October 31, 1968, for $147,391.48, plus statutory interest thereon. This recommendation was adopted by the court by order entered

December 2, 1977, and judgment was entered for plaintiff for $147,391.48, plus statutory interest thereon. The order also included the following footnote.*

No. 389–74. NOVEMBER 11, 1977

Space Research Corporation

Pleading and practice; summary judgment; remand to trial division.—On November 11, 1977 the court entered the following order:

Ralph W. Brenner, attorney of record, for plaintiff. *James W. Gould, Stephen A. Madva, Montgomery, McCracken, Walker & Rhoads,* of counsel.

Howard G. Slavit, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant. *Procurement Legal Division, Office of Chief Counsel, Federal Aviation Administration,* of counsel.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"This case comes before the court on defendant's motion for summary judgment. Plaintiff has alleged several causes of action arising out of negotiations between the Federal Aviation Administration and plaintiff over the sale of computerized simulators for training air traffic controllers. No formal contract signing ever took place, but plaintiff offers theories of express contract, implied contract, equitable estoppel, and arbitrary procurement cancellation as alternative grounds for recovery.

"Defendant filed a motion for summary judgment, disclaiming all liability and offering massive evidentiary support for its motion. Plaintiff's answer is equally voluminous. Because the court believes there is a substantial likelihood that part or all of the case can be resolved by summary judgment yet wishes the assistance of a trial

* Whereas the stipulation of the parties filed November 29, 1977, provides that with respect to the fiscal year ended October 31, 1967, the parties stipulate that the case may be dismissed with prejudice, that portion of plaintiff's claim was previously dismissed on allowance March 7, 1975, of plaintiff's motion to dismiss voluntarily paragraph 4 of plaintiff's petition.

judge in the review of the numerous documents and affidavits submitted, which raise potential factual disputes,

"IT IS HEREBY ORDERED that the case is referred to the Trial Division under Rule 54 for a recommendation on defendant's motion, or for other proceedings in the discretion of a trial judge pursuant to Rule 55."

No. 26–75. NOVEMBER 11, 1977

Yukon Service, Inc.

Contracts; disputes; default termination; discontinuance of performance; claim redressable under contract; trial de novo on basis of contract breach; counterclaim, scope of relief.—Plaintiff contracted to construct a campground road in southeastern Alaska for the Forest Service, the road to consist of two segments: an access road leading from the main highway located in a rocky area that required blasting, and a loop with parking spurs located in an area where the saturated soil was highly unstable when disturbed. Difficulties arose as the result of plaintiff's excavation procedures and the type of equipment it used, and ultimately the contract was default terminated. The contract appeals board found that the default termination was proper and, on the ground that plaintiff's refusal to proceed with the work did not justify forfeiture of acquired rights, the board allowed equitable adjustments for work done prior to the termination. The board also permitted excess reprocurement costs to be assessed, and dismissed defendant's claim for liquidated damages. This suit followed. On April 26, 1977 Trial Judge Kenneth R. Harkins filed a recommended decision (reported in full at 24 CCF para. 81,822) concluding that the decisions of the board are supported by substantial evidence and are correct as a matter of law. As to defendant's counterclaims, the trial judge concluded that, to the extent that the counterclaims are part of disputed matters involved in the default termination, or in plaintiff's appeals for equitable adjustments under the changes and the changed conditions clauses of the contract, the counterclaims may be reviewed in this court. On November 11, 1977 the court, by order, adopted the recommended decision as the basis for its

judgment in this case, and dismissed both the petition and defendant's counterclaims.

No. 264–75. NOVEMBER 11, 1977

J.G. Lockard Construction
Company, Inc.

Contracts; constructive change order; removal of subcontractor by defendant.—Plaintiff was awarded a fixed-price contract to construct two 180-man dormitories at Eglin Air Force Base, Florida. During performance a Government assistant area engineer ordered plaintiff's masonry subcontractor removed from the job. Plaintiff argued that the alleged removal constituted a constructive change order entitling it to an equitable adjustment for all additional costs incurred as a result of having to obtain a replacement subcontractor. Plaintiff based its legal claim on *Liles Constr. Co.* v. *United States*, 197 Ct.Cl. 164, 455 F.2d 527 (1972). The ASBCA denied plaintiff's claim for an equitable adjustment, finding that the assistant area engineer neither expressly nor impliedly ordered the subcontractor's employees off the job site and not to return, and concluding that plaintiff had failed to establish the necessary factual predicate upon which it could claim relief under *Liles, supra.* In a recommended opinion (reported in full at 24 CCF para. 81,823), Trial Judge Joseph V. Colaianni concluded that plaintiff failed to meet its burden of showing that the Board's finding is fraudulent, capricious, arbitrary, so grossly erroneous as to imply bad faith, or not supported by substantial evidence (41 U.S.C. § 321), and as a result the Board's decision was final and conclusive. On November 11, 1977, by order, the court adopted the recommended decision as the basis for its judgment in this case, ordered that plaintiff is not entitled to recover, and dismissed the petition.

No. 449-75. NOVEMBER 11, 1977

Norris Industries, Inc.

Renegotiation of contracts; pleading and practice; discovery; segregation of product lines; cost allocation.—On November 11, 1977 the court entered the following order:

William H. Allen, attorney of record, for plaintiff. *David L. Hirsch, R. James Shaffer,* and *Covington & Burling,* of counsel.

Maryann Clifford, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant. *Robert E. Richardson* and *Gerald D. Freed,* of counsel.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"This case comes before the court on plaintiff's requests, filed August 5, 1977, and September 8, 1977, for review of a trial judge's procedural orders of July 28, 1977, and August 23, 1977, respectively. Both requests concern the same subject matter, discovery of financial data already compiled by plaintiff, but the second follows the trial judge's modification of the order complained of originally. Therefore, we regard the first request for review as mooted and treat only with the second which the trial judge has certified for review (Rule 53(c)(2)(i)).

"The trial judge in this renegotiation case concerning plaintiff's fiscal year 1969 has ordered plaintiff to produce documents reflecting contract-by-contract costs and profits for fiscal years 1964 through 1970. Such documents were prepared quarterly by plaintiff for both renegotiable and nonrenegotiable work, but the discovery allowed concerns only renegotiable work plus one narrow area of nonrenegotiable work where the manufacturing process was apparently highly similar to that involved in producing certain of the renegotiable products. Defendant's request for discovery was in response to this court's implicit invitation, in its May 27, 1977 order (214 Ct.Cl. 776) to defendant to submit 'more circumscribed Rule 74 discovery requests' than the one there denied. At that time, defendant was seeking access to product line financial

information on all renegotiable and nonrenegotiable products made by plaintiff.

"Our May 27 order directed that the trial judge specify his reasons for decisions on discovery motions, but this motion for review brings before us no papers indicating his compliance with this directive. Nonetheless, we are prepared to rule on the motion, believing that defendant's brief and parts of the affidavit of its expert, Dr. Mock, set forth adequate justification for the trial judge's order.

"We recognize that discovery cannot be limitless. But we note that the information here has already been compiled by plaintiff, and that protection of plaintiff's privacy vis-a-vis its competitors has been secured by the trial judge's directive that defendant keep information thusly obtained confidential. Our determination that the records sought are properly discoverable does not foreclose a challenge to their admission into evidence. We understand that defendant's intention is not to use the statements in the form they are now in but to work them up into a more cumulative or comprehensive form, segregating plaintiff's experiences by product rather than by contract.

"The scope of defendant's discovery request is now more reasonably related to the issues in litigation, focusing almost exclusively on plaintiff's renegotiable work. Plaintiff's contention that all its renegotiable ordnance metal parts work should be regarded as a single product line is untenable, regardless of how plaintiff reports such production to the SEC and FTC; renegotiation is a different process with distinct issues. Renegotiation, this court has said repeatedly, is a comparative process, and the information sought here 'appears reasonably calculated to lead to the discovery of admissible evidence' relevant to the comparative process. *See* Rule 74(c).

"As the court's May 27 order makes clear, we are aware 'that cost allocation among different products of the same plant is an eminently inexact science.' Our approval of the discovery here ordered by the trial judge does not mean we will give evidence developed through this discovery more weight than it deserves. Nevertheless, defendant will have no chance to meet its burden of proof without being allowed reasonable access to plaintiff's financial records.

"Now, therefore, upon consideration of the parties' briefs, but without oral argument,

"IT IS ORDERED that plaintiff's August 5, 1977, request for review is denied (because mooted by the later request) and plaintiff's September 8, 1977, request for review is granted. Upon review, the trial judge's procedural order of July 28, 1977, as modified by his order of August 23, 1977, is affirmed."

No. 397–76. NOVEMBER 11, 1977

Lloyd Wood Construction Co., Inc.

Court of Claims jurisdiction; Small Business Emergency Relief Act; legislative intent; loss incurred by termination of wage-price controls.—On November 11, 1977 the court entered the following order:

Olin W. Zeanah, attorney of record, for plaintiff. *Wilbor J. Hust, Jr.,* and *Zeanah, Donald and Hust,* of counsel.

Anthony Thompson, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"This case comes before the court on defendant's motion to dismiss for lack of jurisdiction and for failure to state a claim for which relief can be granted. Having considered the parties' written submissions, the court, without oral argument, grants defendant's motion.

"Plaintiff entered into a fixed-price contract on August 25, 1972, under which it agreed to construct 300 units of family housing for $5,838,164. It alleges that the termination of wage-price controls caused a steep increase in construction costs, so that plaintiff lost $911,342.65 as of December 31, 1975, by performing the contract. It is plaintiff's contention that the passage of the Small Business Emergency Relief Act, Pub. L. 94–190, 89 Stat. 1095 (1975), entitled it to be reimbursed by the Government for the losses suffered. Such a claim was made to the contracting officer on the construction contract. He denied the claim on June 28, 1976. This determination was

affirmed by the Acting Division Engineer of the Army Corps of Engineers on September 24, 1975. Five days later, this suit was filed.

"No provision in the contract conferred upon plaintiff any entitlement to relief for expenses exceeding the fixed price stated in the contract.[1] No constitutional obligation creates such entitlement either. Therefore, plaintiff can establish jurisdiction only if the statute, expressly or by fair implication, creates an entitlement to monetary relief. *See United States* v. *Testan*, 424 U.S. 392 (1976); *Eastport S.S. Corp.* v. *United States*, 178 Ct. Cl. 599, 372 F.2d 1002 (1967). We find no evidence that the statute creates any entitlement to monetary relief.

"The legislation invoked by plaintiff was enacted 'to provide relief to small business concerns which have fixed-price Government contracts in cases where such concerns have suffered or can be expected to suffer serious financial loss because of significant and unavoidable difficulties during performance because of the energy crisis or rapid and unexpected escalations of contract costs.' Sec. 2, Pub. L. 94–190. Plaintiff, arguing that the legislation was designed to apply to situations just like the one in which it found itself, contends the law required that it be given assistance in the amount of its contract losses. Two flaws, each fatal in itself, mar plaintiff's analysis.

"First, the Act does not authorize monetary awards to every contractor whose performance has been more expensive than the agreed contract price. Instead, the Act authorizes only limited remedies under specific circumstances. Subsection 4(a) allows agency heads, upon the application of small business concerns, to terminate contracts for the convenience of the Government upon certain findings. Subsection 4(c) provides for the extension of performance timetables necessitated by shortages of

[1] Plaintiff's claim for reformation, revision, and modification of the contract lacks merit. Plaintiff argues that the parties did not intend that plaintiff would lose money on the contract. Yet no reason has been advanced why the court should ignore the fixed-price nature of the contract, which clearly evidences a mutual intent that the risk of increasing expenses should be borne by the contractor. As in *Tony Downs Foods Co.* v. *United States*, 209 Ct. Cl. 31, 42, 530 F.2d 367, 373 (1976), plaintiff's 'mistaken judgment as to economic conditions, and the continued existence of the price freeze, [is] a mistake for which relief cannot be granted.'

energy supplies. Only subsection 4(b) even permits, much less requires, the payment of moneys beyond amounts specified by contract. It authorizes agency heads to modify terms of certain contracts. But the benefits of subsection 4(b), like those of subsection 4(c), are limited to contractors who request termination for the convenience of the Government, and they may only be attained where the contract modification complies with guidelines from the Office of Federal Procurement Policy. Those guidelines direct that relief be 'limited to those small business firms whose overall financial position is so poor that their ability to survive, without relief under the Act, is in question.' The determination by the Acting Division Engineer that plaintiff did not meet this standard has not been challenged here.

"Even if the Act contemplated monetary relief in situations such as plaintiff's, a second hurdle would block plaintiff's path to recovery. That is, whatever relief the Act authorizes is permissive, not mandatory. Being a small business with the problems sought to be remedied by the Act does not suffice to establish entitlement to relief. Instead, the statute and its legislative history make it clear that no relief, other than extension of contract timetables, can be had without a prior determination by the head of an agency that such relief is appropriate. In short, the relief contemplated by the Act is discretionary with the agency. This is evident from the language of the statute itself which provides that 'the head of * * * [an] agency *may* modify the terms of the contract * * *.' Subsec. 4(b). [Emphasis supplied.] The plain meaning of this language is made wholly unambiguous by the alternative language chosen in subsection 4(c), which provides that where energy shortages cause delay in the performance of a contract 'the head of * * * [an] agency, or his designee, *shall* provide by modification to the contract for an appropriate extension * * *.' [Emphasis supplied.]

"The legislative history of the Act reinforces our conclusion that the choice to leave monetary relief discretionary with the agency was deliberate. The House Report explaining the bill stated: 'Legislation is needed to enable the Government agencies to grant relief *at their*

discretion to eligible small business fixed-price contractors.' [Emphasis supplied.] H. REP. No. 94–154, 94th Cong., 1st Sess., 1975 U.S. CODE CONG. & AD. NEWS 2198. The Report continued: '*The bill would not require that the executive agency provide any relief but would merely authorize the head of the agency* to either terminate the contract for the convenience of the Government without cost to the contractor or to modify the terms of a fixed-price contract, i.e., *to grant a price increase* * * *.' [Emphasis supplied.] *Id.* at 2199. This legislative history reinforces the unambiguous language of the statute, leaving no doubt that a small business concern has no *entitlement* to monetary relief of the sort required to establish jurisdiction under the *Eastport* and *Testan* cases, cited above. The only conceivable grounds for a contrary decision in view of the foregoing would be a showing that the contracting officer's determination was illegal because it was arbitrary or capricious or in violation of some applicable statute or regulation. Plaintiff has pleaded nothing to show that is the situation here.

"Plaintiff thus does not have a claim for monetary relief within this court's jurisdiction and fails to state a claim on which relief can be granted.

"IT IS THEREFORE ORDERED AND CONCLUDED that defendant's motion to dismiss the claim for lack of jurisdiction is granted, and plaintiff's petition is dismissed."

Plaintiff's request for rehearing was denied January 13, 1978. On April 24, 1978 plaintiff filed a petition for a writ of certiorari.

No. 400–76. NOVEMBER 11, 1977

Cloide C. Branning, d/b/a Pleasant Point Plantation, a Partnership

Eminent domain; avigation easement; sufficiency of pleading regarding taking; motion for judgment on the pleadings.—On November 11, 1977 the court entered the following order:

W. Jefferson Leath, attorney of record, for plaintiff.

Walter Driver, Jr., attorney of record, for Third-Party Petitioner. *Joseph R. Bankoff* and *Philip C. Potter, Jr.*, of counsel.

C. David Redmon, with whom was *Assistant Attorney General James W. Moorman*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This case is before the court on the defendant's motion for judgment on the pleadings under Rule 38(c). The motion pertains only to the petition filed in action No. 400–76. We deny the motion without oral argument.

"Plaintiff, Cloide C. Branning, d/b/a Pleasant Point Plantation, a partnership, owns certain lands located in Beaufort County, State of South Carolina. The property is zoned for residential use and the plaintiff has been attempting to develop it into a residential subdivision. The property is located near or adjacent to a Marine Corps Air Station, which the Department of Navy operates in Beaufort County. It appears that the air flights to and from the Marine Corps Air Station have materially affected the desirability of using plaintiff's property for residential purposes. A July 1976 Department of Navy study of the effect of the noise and crash potential from the Marine Corps Air Station on the surrounding area concluded that plaintiff's property is located in a CNR Zone 3, the highest noise level. The location of residential units, hospitals, schools, and churches is not recommended within a CNR Zone 3 area.

"Defendant has moved for judgment on the grounds that, admitting all plaintiff alleges, the petition fails to state a claim for relief. Defendant contends the mere publishing of the July 1976 Department of Navy study, making public the fact that plaintiff's planned subdivision was not a desirable residential area, does not constitute grounds for a taking of plaintiff's property.

"A motion for judgment on the pleadings should be denied unless it appears to a certainty that plaintiff is entitled to no relief under any state of facts which could be proved in support of his claim. *Brown* v. *Bullock*, 194 F.

Supp. 207 (1961), *aff'd* 294 F. 2d 415 (1961); *Rosenhan* v. *United States*, 131 F. 2d 932 (1942), *cert. denied*, 318 U.S. 790 (1943); *Kohen* v. *H. S. Crocker Co.*, 260 F. 2d 790 (1958). It has been established that air flights over property can result in a taking for which just compensation must be paid. *United States* v. *Causby*, 328 U.S. 256 (1946).[1] When involuntary taking was claimed, due to gunfire over the claimant's property, greater liberality was allowed in the claimant's pleadings. *Portsmouth Harbor Land & Hotel Co.* v. *United States*, 260 U.S. 327 (1922). Similarly, when it is by planes, since frequency and route data are all in the defendant's custody, we should allow the plaintiff more liberality as the Court did in *Portsmouth Harbor Land & Hotel Co.*

"Here plaintiff alleges more than the mere publishing of the July 1976 Department of Navy study as a basis for the taking. In paragraph seven of the petition, plaintiff alleges 'that as a direct and proximate result of the operations of jet aircraft from the Marine Corps Air Station, Beaufort County, South Carolina, * * * the respondent has deprived the petitioner of the free and unmolested quiet enjoyment of his property.' This allegation sounds analogous to the taking which was upheld in *United States* v. *Causby, supra.* Although defendant denies the above allegation and facts relating to it in its answer, it may be inferred from the general allegations that there were flights over plaintiff's property. Based upon plaintiff's allegations, this court is of the opinion that plaintiff has stated a claim upon which relief may be granted. Therefore,

"IT IS ORDERED that defendant's motion for judgment on the pleadings is denied."

No. 505–76. NOVEMBER 11, 1977

Norma Denton

Court of Claims jurisdiction; Servicemen's Group Life Insurance; tort claim; transfer of case to district court.—On November 11, 1977 the court entered the following order:

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[1] *See also Gilliland* v. *United States*, *post* at 953.

Alan L. Froelich, attorney for plaintiff. *Wendells, Froelich, Power & Lakefish*, of counsel.

Robert M. Hollis, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, *Judge*, Presiding, KUNZIG, and BENNETT, *Judges*.

"This claim for Servicemen's Group Life Insurance benefits is before the court on defendant's motion to dismiss for lack of jurisdiction. Plaintiff (the surviving widow of Lt. Col. Charles K. Denton) sets out two grounds for recovery. One is against the Department of the Army, alleging that Col. Denton lost his opportunity to participate in the insurance program because of the Army's error in failing to notify him of his eligibility. The other is against the Office of Servicemen's Group Life Insurance (OSGLI), alleging that the OSGLI has refused to remit death benefits which would have been payable had Col. Denton participated in the insurance plan. Neither ground of the petition states a claim within our jurisdiction. We, therefore, grant defendant's motion and dismiss the petition.

"Plaintiff makes several assertions, all of which we accept as true for purposes of this motion. Her husband, now deceased, Lt.Col. Charles K. Denton, was a member of the Retired Reserve and eligible for Servicemen's Group Life Insurance (SGLI) pursuant to 38 U.S.C. §§ 765–779 (1970 & Supp. V 1975). Though the SGLI program was extended (effective May 24, 1974) to certain members of the Retired Reserves, Col. Denton was never informed by the Army of his eligibility; he never participated in the plan; and, upon his death, the OSGLI has refused to pay plaintiff the $20,000 proceeds of an SGLI policy.

"Plaintiff's first contention is that her husband was denied the opportunity to participate in the SGLI program becaused of the Army's error in failing to notify him of his eligibility.

"Though we accept as true plaintiff's allegation that the Army has, indeed, undertaken to notify Retired Reserve members of their SGLI eligibility, this does not enhance plaintiff's cause before us. To say that the Army has

undertaken, and then failed, to notify is to allege a cause of action sounding in tort over which this court has no jurisdiction. 28 U.S.C. § 1491.

"Next we examine the appropriate statute to see what obligations the Army might have toward plaintiff in the area of life insurance. Such obligations, if any, would be controlled by the SGLI statute, 38 U.S.C. §§ 765–779 (1970 & Supp. V 1975), the latest relevant enactment by Congress in this sphere. But this court has previously held that 38 U.S.C. § 775 grants exclusive jurisdiction over SGLI claims to the United States district courts. *Parker* v. *United States*, 196 Ct.Cl. 775 (1971) (effectively overruling *Ross* v. *United States*, 195 Ct.Cl. 529, 444 F.2d 568 (1971) on the jurisdictional point upon which plaintiff relies). *Accord* 38 U.S.C. § 211(a). We are, therefore, without jurisdiction to consider claims based on the SGLI statute.

"Plaintiff's second argument, that the OSGLI has refused to remit death benefits payable, is based squarely on the same SGLI statute. We are again without jurisdiction. *Parker, supra.*

"IT IS HEREBY ORDERED, upon consideration of the briefs, and without oral argument, that defendant's motion to dismiss is granted and the petition is dismissed. Plaintiff does not ask that we transfer this case to the district court."

By order entered January 13, 1978 the court vacated that portion of the foregoing order granting defendant's motion to dismiss and dismissing the petition. The court ordered that plaintiff's motion to transfer be granted pursuant to 28 U.S.C. § 1506 and transferred the case to the United States District Court for the Western District of Washington at Seattle.

No. 546–76. NOVEMBER 11, 1977

Robert J. Gilliland, et al.

Eminent domain; inverse condemnation; avigation easement; regulatory activity; tort claim; remand to trial division.—On November 11, 1977 the court entered the following order:

Michael M. Berger, attorney of record, for plaintiffs. *Jerrold A. Fadem, Gregory M. Bergman, Fadem, Berger, McIntire & Norton*, of counsel.

C. David Redmon, with whom was *Assistant Attorney General James W. Moorman*, for defendant.

Before DAVIS, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

"This taking claim comes before the court on defendant's motion for summary judgment (or, in the alternative, for dismissal), opposed by plaintiffs who seek a trial. For the reasons stated below, the motion is denied.

"Plaintiffs are the owners of two parcels of land near Air Force Plant 42 in the County of Los Angeles, which plant includes a military airport and a plant for manufacturing and testing by commercial firms for the Air Force.

"Plaintiffs' parcels were located by the main entrance to the Lockheed plant, situated near the airport, and both parcels are directly beneath the approach path for runway 4 and the departure path for runway 22.

"Plaintiffs base their taking claim on two distinct theories of liability. The familiar theory of taking based on aircraft overflights is based on the Air Force's failure to acquire enough property in the airport vicinity and alleges that the jet aircraft using the airport have, because of noise, vibration, and fumes, impaired the utility, marketability, and value of the properties. The other theory of liability is based on the Air Force's alleged influence on the Palmdale City Council and the Los Angeles County Board of Supervisors, which allegedly caused their respective denials of plaintiffs' applications to rezone the two parcels from single family residential to commercial planned development zones.

"Defendant has moved for summary judgment, alleging the facts pleaded bring the case squarely within the holding of *De-Tom Enterprises, Inc.* v. *United States*, 213 Ct. Cl. 362, 552 F.2d 337 (1977), where the United States was held not liable for its role in influencing a county board of supervisors to refuse a zoning application. Plaintiffs offer

several distinctions between their case and *De-Tom* and allege that further fact finding is necessary.

"In *De-Tom*, plaintiff was found by the court to have acquiesced in the county board's decision, leaving plaintiff with the untenable argument that the United States could be held liable for influencing a proper and lawful result. Here, by contrast, plaintiff has challenged the adverse zoning decisions in state court and does not agree that the decisions influenced by the United States were proper. Too, *De-Tom* emphasized that the Government's regulatory activity cannot create taking liability unless it reached a certain level of extensiveness or intrusiveness, so long as there is no physical damage to or intrusion of plaintiff's property. As indicated above, plaintiffs' claim includes allegations of physical damage or intrusion from jet overflights, and *De-Tom* did not purport to rule upon the Government's liability for taking where physical intrusion or damage has been coupled with regulatory interference. Finally, *De-Tom* emphasized that the actions of the United States before the county board were the same as actions of any other landowner who might present arguments against zoning changes to a board considering a neighbor's application for rezoning. Plaintiffs' opposition to defendant's motion for summary judgment contends the United States went much further here, stating the Government involved itself through private, 'secret' meetings as well as regular public proceedings.

"We are doubtful that these distinctions are sufficient to permit a judgment on the claim based on Government influence. The claims sound essentially in tort, and it hardly needs repeating that this court hears no claims in tort. 28 U.S.C. § 1491 (1970). It is true that Government regulation, if sufficiently extensive or intrusive, may constitute a taking, *see Benenson* v. *United States*, 212 Ct. Cl. 375, 548 F.2d 939 (1977), but it is equally true that the wrongful influencing by the Federal Government of actions by a separate governmental entity is at bottom a claim grounded in tort. *See Sharp* v. *United States*, *ante*, at 883. Nevertheless, we are not inclined to foreclose fact finding and argument on this issue, for we are not eager to grant partial summary judgment where the theories of liability

may be related and a claim cognizable here has been stated.

"We do see a cognizable claim stated in plaintiffs' allegations that the invasion of noise, fumes, and vibration by overflying aircraft constitutes a taking. *See, e.g., United States* v. *Causby*, 328 U.S. 256 (1946).[1] True, plaintiffs have not directly alleged that defendant has invaded their property. *See Batten* v. *United States*, 306 F.2d 580 (10th Cir. 1962), *cert. denied*, 371 U.S. 955 (1963), but we think the petition may be fairly construed to contain jurisdictionally adequate allegations on this point, since defendant has admitted plaintiffs' allegation that both properties lie beneath an approach path and a departure path for airport runways. On this claim there remain disputed issues of material fact which preclude summary judgment. *See* Rule 101(d). As stated above, the remand necessary on this issue makes us unwilling to foreclose inquiry into the matter of Government influence in the zoning applications' denial despite our suspicion that such claim sounds in tort. A more orderly resolution of this claim can be reached by permitting the trial judge to begin proceedings directed to the development of facts sufficient to permit an informed decision of the proper resolution of both of plaintiffs' theories. Should this process force a later decision on the influencing charge, we can at that time decide whether the claim should be dismissed or transferred to a district court pursuant to 28 U.S.C. § 1506 (1970). If plaintiffs should prevail here on a claim for inverse condemnation, the tort claim, if it is such, would be mooted.

"Upon the parties written submissions, but without oral argument,

"IT IS HEREBY ORDERED that defendant's motion for summary judgment, or in the alternative for dismissal, is denied. The case is remanded to the Trial Division for further proceedings."

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[1] *See also Branning* v. *United States*, *ante* at 949.

No. 4–77. NOVEMBER 11, 1977

James E. Brown

Court of Claims jurisdiction; implied contract; tort claim; money missing from assigned Government dormitory quarters.—On November 11, 1977 the court entered the following order:

James E. Brown, pro se.

Stephen G. Anderson, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG, and BENNETT, *Judges.*

"This pro se case is before the court on plaintiff's motion for summary judgment, defendant's cross-motion for summary judgment, and plaintiff's motion to strike portions of defendant's cross-motion. Defendant, in its answer filed March 4, 1977, also requested that we dismiss the petition for failure to state a claim within the jurisdiction of this court. Because we agree with defendant on this point, the court, on its own motion, pursuant to Rule 102(b)(1), dismisses the petition.

"By petition filed in this court on January 3, 1977, plaintiff alleges jurisdiction under 28 U.S.C. § 1491, over a claim founded upon 'breach of implied contract and malicious application of an executive department regulation.' This court, however, does not have jurisdiction over contracts implied in law or claims sounding in tort.

"Plaintiff is a civilian employee of the United States Army who, during the time covered by this complaint, occupied Government dormitory quarters in Frankfurt, West Germany. There is no dispute as to these facts: The Government retained a duplicate key to plaintiff's quarters; the Government employed maids and it was within the scope of their employment to unlock dormitory rooms when inspection, cleaning, or maintenance was required; and, on November 3, 1975, a dormitory maid did (with plaintiff's consent) unlock plaintiff's room while plaintiff was not there.

"Plaintiff alleges that the maid unlocked his door, left maintenance personnel alone in the room while she went

on about her business, and then failed to maintain surveillance over his property during that time the room was open. Plaintiff asserts that he lost $1,480.29 in cash which he had been keeping in his room.

"Plaintiff's first argument is that the maid breached a contractual duty to safeguard his property. Plaintiff claims that there is an 'implied contract' arising out of the use of the duplicate key. An implied contract, to give jurisdiction to the Court of Claims, must be implied in fact. Mere retention of a duplicate key, as alleged here, does not give rise to any inference of tacit understanding so as to create a contract implied in fact. If plaintiff is alleging a contract implied in law, then his claim is beyond the jurisdiction of this court. *Merritt* v. *United States*, 267 U.S. 338 (1925); *Algonac Mfg. Co.* v. *United States*, 192 Ct.Cl. 649, 428 F.2d 1241 (1970).[1]

"Plaintiff's second argument is that his statutory claim for compensation (which he alleges under 10 U.S.C. § 2733, 28 U.S.C. §§ 2671–2680, and 31 U.S.C. §§ 240–243) was denied "maliciously." This court has no jurisdiction over claims sounding in tort. 28 U.S.C. § 1491.[2] Plaintiff does not ask that we transfer this case to the district court.

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[1] "The distinction between contracts implied in fact and implied in law has been defined in 17 C.J.S. *Contracts* § 4 (1963) as follows:

* * * Thus a contract implied in fact is a true contract, the agreement of the parties being inferred from the circumstances, while a contract implied in law is but a duty imposed by law and treated as a contract for the purposes of a remedy only. Another distinction * * * lies in the fact that, * * * in the case of contracts implied in fact, there must be an assent of the parties, as in express contracts, whereas * * * in the case of contracts implied in law, or, more properly, quasi or constructive contracts, such element of assent is lacking.

The distinction has also been stated that a contract implied in fact is an implied contract in which the intention is ascertained and enforced, while a contract implied in law is a mere fiction, the intention being disregarded, and the quasi contractual obligation being imposed by law to bring about justice, without regard to the intention of the parties. * * *

This court does not have jurisdiction of claims based upon contracts implied in law." *Algonac Mfg. Co.* v. *United States*, 192 Ct.Cl. 649, 674, 428 F.2d 1241, 1255–56 (1970).

[2] This petition does not plead sufficient facts from which we can construe an action even colorably within our jurisdiction. Liberally construing this *pro se* petition as including an assertion that denial of plaintiff's statutory claim was an abuse of discretion, we are without sufficient allegations as to how, precisely, the Department of the Army might have erred. One of the statutes upon which plaintiff relies explicitly denies any award upon a finding of contributory neglience; plaintiff's contributory negligence is the ground on which the Army based its decision. Far from being 'erroneous as a matter of law,' the Army's disposition of this case seems

"Since the petition does not allege a cause of action within our jurisdiction, we deny plaintiff's motion for summary judgment and deny plaintiff's motion to strike. For the same reason, we find it unnecessary to reach the legal issues raised by the Government in its cross-motion for summary judgment.[3]

"IT IS HEREBY ORDERED, upon consideration of the pleadings, briefs, and motions, and without oral argument, that plaintiff's motion for summary judgment is denied and plaintiff's motion to strike is denied. We do not reach defendant's cross-motion for summary judgment. Plaintiff's petition is dismissed for failure to state a claim within the jurisdiction of this court."

Plaintiff's motion for reconsideration was denied February 3, 1978.

No. 38-77. NOVEMBER 11, 1977

Pitt River Home and Agricultural Cooperative Association

Court of Claims jurisdiction; pendency of claims in another court; claim for equitable relief and claim for just compensation— On November 11, 1977 the court entered the following order:

Raymond C. Simpson, attorney of record, for plaintiff.

James E. Clubb, with whom was *Assistant Attorney General James W. Moorman,* for defendant.

Before DAVIS, *Judge,* Presiding, NICHOLS and KASHIWA, *Judges.*

"This case is before the court on defendant's motion to dismiss for lack of jurisdiction. Upon the briefs, we deny the motion, without argument.

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to be just what the statute contemplated. 31 U.S.C. § 241(c)(3).

[3] The Government asserts that Congress has precluded judicial review under the statutes involved. The Government also maintains that this case is governed by *Testan* v. *United States,* 424 U.S. 392 (1976). We do not address either contention, neither preclusion of judicial review, nor the rather extravagant reading of *Testan* which is advanced by the Government.

"The plaintiff, Pitt River Home and Agricultural Cooperative Association, has instituted two legal actions against the United States. Both actions are based on the same dispute and involve similar if not identical factual issues. The relief sought in the two actions is clearly different. In the first action, filed December 16, 1976, in the U.S. District Court for the Eastern District of California, plaintiff is seeking equitable relief in the form of an injunction and Writ of Mandate. In the action involved herein, filed January 17, 1977, the plaintiff is seeking just compensation for the unlawful taking of its property.

"The defendant bases its motion to dismiss the plaintiff's petition on 28 U.S.C. § 1500 (1970), which provides:

> The Court of Claims shall not have jurisdiction of any claim for or in respect to which the plaintiff or his assignee has pending in any other court any suit or process against the United States or any person who, at the time when the cause of action alleged in such suit arose, was, in respect thereto, acting or professing to act, directly or indirectly under authority of the United States.

"The defendant contends, and the plaintiff concedes, that, where applicable, 28 U.S.C. § 1500 (1970) acts as a bar to jurisdiction in the Court of Claims. However, 28 U.S.C. § 1500 (1970) is not applicable to this case. This court has repeatedly construed 28 U.S.C. § 1500 (1970) as follows:

> * * * Section 1500 [28 U.S.C. § 1500 (1970)] was designed to require an election between two forums *both* of which could presumably grant the *same type of relief.* * * * [Emphasis supplied.] [*Brown* v. *United States,* 175 Ct. Cl. 343, 348, 358 F. 2d 1002, 1005 (1966).]

See also Tecon Engineers, Inc. v. *United States,* 170 Ct. Cl. 389, 393 *ff.,* 343 F. 2d 943, 945 *ff.* (1965), *cert. denied,* 382 U.S. 976 (1966).

"The defendant concedes in its motion to dismiss that the relief sought in the two cases (the case involved herein and the district court case) is different. Because the district court has the power to offer equitable relief to the plaintiff, if appropriate, while this court has the power to compensate the plaintiff for damages in excess of $10,000, 28 U.S.C. § 1500 (1970) is inapplicable as a bar to this petition.

"It is not novel for the Court of Claims to proceed in actions for money damages wherein the identical factual situations are involved in previously filed district court actions seeking equitable relief. *See, e.g., Brown* v. *United States, supra; Casman* v. *United States,* 135 Ct. Cl. 647 (1956).

"The relevant question in assessing an asserted bar to jurisdiction in the Court of Claims on the basis of § 1500 is not whether similar factual issues are involved in other, previously filed, actions but, instead, whether the same cause of action and claims for relief are asserted in the Court of Claims and other courts. If so, then § 1500 is a jurisdictional bar. *Brown* v. *United States, supra,* at 1004; *Casman* v. *United States, supra.*

"The plaintiff is not alleging the same cause of action nor seeking the same relief herein as is sought in the district court suit. Therefore,

"IT IS ORDERED that defendant's motion to dismiss be and is hereby denied."

No. 155–77. NOVEMBER 11, 1977

William Kent Norris

Eminent domain; limitation of actions; accrual of cause of action; tolling of statute; Redwood National Park Act.—On November 11, 1977 the court entered the following order:

Lawrence O. Eitzen, attorney of record, for plaintiff. *Eitzen, Schaub & Diehl,* of counsel.

Howard O. Sigmond, with whom was *Assistant Attorney General James W. Moorman,* for defendant.

Before DAVIS, *Judge,* Presiding, NICHOLS and KASHIWA, *Judges.*

"This eminent domain case comes before the court, without oral argument, on the defendant's motion to dismiss. The plaintiff brings suit both in the capacity of administrator[1] of his late father's (decedent's) estate and in

[1] In his petition plaintiff stated that he had petitioned to be appointed

his own behalf as a beneficiary of the estate under the decedent's will. He alleges that the decedent was a Yurok Indian, who owned several pieces of real property, which were taken under the Redwood National Park Act, Pub. L. 90–545, 82 Stat. 931 (1968) (codified in 16 U.S.C. §§ 79a–79j (1970)). The Act provided that title to the land would vest in the United States as of October 2, 1968. 16 U.S.C. § 79c(b)(1) (1970). In 1976 the plaintiff made inquiries to the United States Department of the Interior concerning compensation for the taking of the property. After a series of communications, the Department informed the plaintiff that compensation for the taking of the property had been paid to the Simpson Timber Company. The plaintiff filed his petition here on March 21, 1977, claiming that payment should have been made to him or to decedent.

"The defendant bases its motion to dismiss on the ground that suit was not brought within six years of the time the cause of action accrued, as required by 28 U.S.C. § 2501 (1970). The plaintiff's basic contention is that the cause of action should be deemed to accrue as of the time the compensation was wrongfully paid to the Simpson Timber Company, since it was at this time that the plaintiff was damaged. We cannot accept this analysis. The payment to the timber company was not the injury to the plaintiff; rather, it was the taking of the land under the Redwood National Park Act without the payment of compensation to him or to the decedent. It is true that under the Act the Secretary of the Interior could make adjustments to the boundary of the park (16 U.S.C. § 79b(a) (1970)), and that a cause of action does not accrue until the nature and extent of what is taken is clear; there is no need to resort to piecemeal litigation. *Dickinson* v. *United States*, 331 U.S. 745, 749 (1947); *Terteling* v. *United States*, 167 Ct. Cl. 331, 338–39, 334 F.2d 250, 254–55 (1964). Here, however, the plaintiff does not allege that there were any uncertainties about the inclusion of the property in the geographical area to be taken permanently, or that there was any justifiable reason for the decedent's believing at the time of the taking that the Secretary of the Interior would make

administrator of the decedent's estate and would be so appointed in the normal course of events within a few weeks.

boundary adjustments excluding his property from the park. In such circumstances, when the Act declared that all right, title, and interest of all property in the specified area vested in the United States as of a given time, the hypothetical possibility of an adjustment of the park's boundaries could not postpone the accrual of the cause of action. *Cf. Baer* v. *United States*, 164 Ct. Cl. 447, 451, *cert. denied*, 379 U.S. 878 (1964) (the mere possibility of a future international settlement did not alter the fact of deprivation or postpone the accrual of the cause of action). Accordingly, the claim accrued in favor of the decedent at the time stated in the Act, since there was no substantial uncertainty as to the taking of the property. *See Miller* v. *United States*, 209 Ct. Cl. 135, 140, 531 F.2d 510, 512–13 (1976).

"The plaintiff also alleges that, at the time of the taking, the record of ownership of the property was 'complicated and confusing', the plaintiff was unaware of any interest in the land, and in such circumstances he could reasonably expect to have the government make contact with him before there were any negotiations on compensation. We fail to see how the government should be expected to contact the plaintiff in regard to compensation, when he, the son of the alleged former owner of the land, was unaware of the property question because of 'complicated and confusing' property records.[2] In any event, nothing in these facts militates against the conclusion that the statute of limitations began to run as of October 2, 1968. Mere ignorance of a cause of action does not stay the running of the statute; only if a plaintiff shows that he was kept ignorant of his cause of action by the acts of the defendant or that the plaintiff's injury is 'inherently unknowable' is the running of the statute suspended. *Spevack* v. *United States*, 182 Ct. Cl. 884, 889–90, 390 F.2d 977, 981 (1968); *Japanese War Notes Claimants Ass'n* v. *United States*, 178 Ct. Cl. 630, 634, 373 F.2d 356, 358–59, *cert. denied*, 389 U.S. 971 (1967). There is nothing 'inherently unknowable' about an allotment made to the decedent himself, when the decedent received a deed for it, or about a property interest

[2] The defendant states that it paid the compensation to the timber company on the basis of a certificate of title furnished by a recognized title company.

which he received from his mother.[3] Likewise, the creation of the National Redwood Park by Congressional enactment scarcely qualified as a covert act by the defendant.

"There is no other ground for holding that the claim failed to accrue as of the time of the taking specified in the Act.[4] The fact that decedent happened to be an Indian does not alter the effect of the statute of limitations on this claim for just compensation for a taking of individual property. *See Capoeman* v. *United States*, 194 Ct. Cl. 664, 440 F.2d 1002 (1971). Similarly, the decedent's death did not suspend the running of the statute, nor does the fact that the plaintiff is bringing suit as administrator of the estate stay the operation of limitations. *Whitney's Adm'x* v. *United States*, 18 Ct. Cl. 19, 24 (1883); *O'Connell* v. *United States*, 37 F.Supp. 832, 833 (E.D. Ill. 1941).

"It is therefore ordered and concluded that the defendant's motion to dismiss is granted and that the plaintiff's petition is dismissed."

No. 181-77. NOVEMBER 11, 1977

O. Frank Woolf

Civilian pay; Civil Service retirement; period of separation; interest payment on withdrawn funds.—On November 11, 1977 the court entered the following order:

O. Frank Woolf, pro se.

Gerald L. Schrader, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG, and BENNETT, *Judges.*

"This *pro se* action for recovery of interest paid on monies withdrawn, and then repaid, to the Civil Service Retirement Fund (CSRF) is before the court on defendant's

[3] The decedent apparently lived most of his life in an area within the present boundaries of the park.

[4] The plaintiff does not state when the decedent died. What we have said is equally applicable if the decedent died before the time of the taking. Title vests upon the devisees of a will at the time of death by operation of law in California. Cal. Prob. Code § 300 (West 1956). Thus, their causes of action would accrue at the time of the taking.

motion for summary judgment, plaintiff's cross-motion for summary judgment, and plaintiff's motion to dismiss defendant's motion. We hold for defendant.

"Plaintiff, in a petition filed on April 5, 1977, alleges jurisdiction in this court under 28 U.S.C. § 1491. He contends that he was 'illegally required' to pay the sum of $980.00 in interest on the $1786.00 which he withdrew from the CSRF, when he left federal employment in 1949, and then repaid, over the course of twenty-four years, after he returned to federal employment in 1950. He argues that he was forced to pay this interest only because the Civil Service Commission (CSC) wrongly construed 5 U.S.C. § 8334(e), which reads, in pertinent part:

> . . . Interest may not be charged *for a period of separation* from the service which began before October 1, 1956. (emphasis added)

"Plaintiff argues that, because his one-year separation began in 1949, he should not be charged any interest on any of the money which he held out of the CSRF for nearly twenty-four years after beginning his subsequent federal employment. Plaintiff cites no judicial determination or legislative history that would support his interpretation of the section.[1] We find his argument unconvincing.

"Defendant answers simply, citing the statutory language and extensive legislative history, that the purpose of the quoted portion of § 8334(e) was to prevent payments on money held during 'periods of separation' and that plaintiff was not charged any interest for his one-year period of separation. Plaintiff was charged interest only for the

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[1] Even the letter from the Assistant General Counsel of the CSC, upon which plaintiff relies so heavily, states that an employee may be

". . . charged interest on a redeposit of a refund for the time *from the date of his reemployment* and subsequent breaks in service that began on or after October 1, 1956. Therefore, your retirement counselor was incorrect in stating that an employee separated from service prior to October 1, 1956, and subsequently reemployed may be charged interest . . . covering the *period of separation from the service.*" (emphasis added)

We believe this to fairly state the position which defendant has consistently maintained. It is possible that the Assistant General Counsel could have answered plaintiff with more particularity had he known his answer would become the basis of a personal claim. However, we note that plaintiff's original inquiry was sent on National Labor Relations Board letterhead, requested a general interpretation for 'all departments,' and in no way related the specific facts now in issue.

period, after federal reemployment, when he was again covered by the Civil Service Retirement Act, but retained funds due the CSRF.

"We find the statutory language clear on its face, and the legislative history overwhelmingly in favor of defendant's interpretation. The obvious purpose and effect of § 8334(e) is to allow recovery of interest by the CSRF on funds withheld by federal employees *during periods of federal employment,* but to preclude such recovery on funds withdrawn and held while an individual *was not federally employed,* so long as that period of non-federal employment began prior to October 1, 1956.[2] This is precisely the effect given § 8334(e) by the CSC.

"For the reasons stated, we reject plaintiff's assertion that he was 'illegally required' to pay the interest accruing during his subsequent period of federal employment and hold that the CSC acted properly in charging him that interest while excluding the interest accruing during his one-year period of separation.

"IT IS HEREBY ORDERED, upon consideration of the pleadings, motions, and briefs in support thereof, without oral argument, that defendant's motion for summary judgment is granted, plaintiff's cross-motion for summary judgment is denied and plaintiff's motion to dismiss defendant's motion is denied. The petition is dismissed."

No. 186–77. NOVEMBER 11, 1977

The Tuscaloosa Nation, a/k/a
The Musawa Tuscaloosa

Indian claims; Indian Claims Commission jurisdiction; limitation of actions. On November 11, 1977 the court entered the following order:

Moses H. Smith, attorney of record, for plaintiff.

Richard L. Beal, with whom was *Assistant Attorney General James W. Moorman,* for defendant.

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[2] *See, e.g.,* 103 Cong.Rec. 633 (1957)(statement by Congressman Hemphill, the sponsor of the bill, containing the language in question); H.R. Rep. No. 540, 85th Cong., 1st Sess. (1957) *reprinted in* [1957] U.S. Code Cong. & Ad. News 1265–67 (committee explanation of H.R. 3048, Congressman Hemphill's bill).

Before DAVIS, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"The Tuscaloosa Nation has filed a 'Petition for Compensation for Lands Taken,' asserting that 'on or about July 4, 1776, the government of the United States of America' took without payment certain of the Nation's tribal lands which the Nation had possessed and occupied from time immemorial. The suit is apparently sought to be filed under 28 U.S.C. § 1505. The defendant has moved to dismiss on a number of grounds, of which we need consider only one.

"That fatal defect is that the claim clearly arose, from the statement in the petition itself, almost two centuries before August 13, 1946, the date of enactment of the Indian Claims Commission Act, 25 U.S.C. §70 *et seq.* Moreover, the claim for the taking of aboriginally owned land was within that Commission's jurisdiction. *Otoe and Missouria Tribe of Indians v. United States*, 131 Ct. Cl. 593 (1955), *cert. denied*, 350 U.S. 848. Section 12 of the Claims Commission Act, 25 U.S.C. § 70h, provides that claims existing prior to the enactment date which could have been but were not filed with the Commission within five years of that date cannot 'thereafter be submitted to any court or administrative agency for consideration, nor will such claim thereafter be entertained by the Congress.' Congress obviously required all pre–1946 claims for takings to be submitted to the Commission by 1951, and in that connection forbade this court and all others from entertaining that kind of pre–1946 claim. This is confirmed by 28 U.S.C. § 1505, the only basis for a suit in this court by an Indian group, which declares (in part) that this court shall have jurisdiction 'of any claim [by an Indian group] against the United States accruing *after* August 13, 1946 * * *' (emphasis added). Except for a few special acts relating to specific claims or named Indian groups, Congress has not lifted this bar to our consideration of pre–1946 Indian claims.[1]

"It is therefore ordered and concluded that defendant's motion to dismiss is granted and the petition is dismissed."

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[1] Plaintiff refers to the Act of October 13, 1972, Pub. L. No. 92–485, 86 Stat. 803, but that statute relates to suits by the Government, not against it.

No. 320–77. NOVEMBER 11, 1977

Thomas H. Garrett

Court of Claims jurisdiction; tort claim; miscarriage of mail. —On November 11, 1977 the court entered the following order:

Thomas Harold Garrett, pro se.

Alan L. Ferber, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"In this *pro se* case plaintiff asserts that in May 1977 he mailed to this court, by certified mail, a notarized 'complaint', but that through the Government's 'neglect and default' the document was misdelivered to and mistakenly accepted by the United States District Court for the District of Columbia. He asks $500,000 in punitive damages and $499,999.99 in compensatory damages. Although he states that 'the complaint in the original mail packet * * * was of acute value' to him, he does not say how he was injured by the misdelivery.

"Defendant moves to dismiss on the ground that the claim, if any, plainly sounds in tort, and that this court has no original jurisdiction of tort suits. That proposition is, of course, beyond dispute. *See, e.g., Vincin v. United States,* 199 Ct. Cl. 762 (1972); *Algonac Mfg. Co. v. United States,* 192 Ct. Cl. 649, 663 (1970). We have no power to entertain the claim plaintiff presents. Nor is there any point to transfer of the case to a district court, pursuant to 28 U.S.C. § 1506, for processing under the Tort Claims Act since that statute excepts from its coverage 'any claim arising out of the loss, miscarriage, or negligent transmission of letters or postal matter' (28 U.S.C. § 2680(b)).

"It is therefore ordered and concluded that defendant's motion to dismiss is granted and the petition is dismissed."

No. 369-77. NOVEMBER 1, 1977

Melvin A. Marshall

Civilian pay; promotions; entitlement to.—On November 11, 1977 the court entered the following order:

Melvin A. Marshall, pro se.

Anthony Thompson, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, NICHOLS and KASHIWA, *Judges.*

"This civilian pay case is before us on the petition, defendant's motion for summary judgment, and plaintiff's opposition thereto.

"Plaintiff is black. In 1970 he was 'hired into' the Federal Highway Administration, Civil Rights Division, as a GS–7 trainee, with a promotion commitment as follows:

> Upon satisfactory completion of the training program, employees are eligible for promotion to the next highest grade level * * *

which was GS–9. Defendant concedes that, for purposes of its motion, he did complete the training program satisfactorily, his superiors, who purported to determine the contrary, having been overruled by the Civil Service Commission. But the Commission did not order his promotion. He was not promoted, and in 1972 was removed under a R.I.F., while still a GS–7. He prosecuted a complaint of racial discrimination, and sued in the U.S. District Court, which found that all the discrimination was in plaintiff's favor. The D. C. Circuit affirmed. These decisions are unreported.

"Plaintiff attempts here to frame a cause of action that is not barred by the findings in the former decision. This accounts for the relative narrowness of the issue he tenders for our decision. He says in substance that he had a legal right, upon satisfactory completion of his trainee period, to be promoted to GS–9, and no GS–9 position was abolished in the R.I.F. Hence he would have remained on the payroll and have moved up the promotion ladder as he became eligible to higher grades, to GS–12 at present, with periodic step increases, besides. He sues for the difference between

the pay of those grades and pay received, plus reinstatement.

"The difficulty is that without having been promoted or become legally entitled to promotion, plaintiff cannot sue here for the pay of the positions he claims. *Peters* v. *United States*, 208 Ct. Cl. 373, 534 F.2d 232 (1975). Eligibility for promotion is not the same thing as legal entitlement and does not sustain our jurisdiction to grant relief. *Doggett* v. *United States*, 207 Ct. Cl. 478 (1975). Assuming then, that plaintiff was eligible for promotion from the completion of this training period until he was R.I.F.'d, that does not show he was promoted or legally entitled to promotion.

"Since the claim to pay of a GS–9 fails, the claims to subsequent higher grades likewise fail, as does the claim to reinstatement, which can be ordered only as an incident to monetary relief.

"Accordingly, upon consideration of the motion and plaintiff's opposition, but without oral argument, it is ordered that defendant's motion for summary judgment be granted and that the petition be dismissed."

Plaintiff's petition for a writ of certiorari was denied March 20, 1978.

No. 353–73. NOVEMBER 25, 1977

Sacramento Northern Railway

Carriers; demurrage charge; damage to freight cars.—Plaintiff seeks to recover demurrage charges which allegedly accrued while two railroad cars, damaged as a result of defendant's activities, stood idle for 3 and 13 months, respectively, on the tracks of the United States Naval Weapons Station at Clyde, California. In a recommended opinion filed October 12, 1977, Trial Judge Joseph V. Colaianni concluded that plaintiff is entitled to recover demurrage, though in a lesser amount than that claimed. This case came before the court on the parties' stipulation for settlement, whereby plaintiff agreed to accept the sum of $10,180 (the amount determined by the trial judge). On November 25, 1977, by order, the court entered judgment for plaintiff for $10,180.

No. 442-74. NOVEMBER 25, 1977

William D. D'Ascenzo

Military pay; discharge; laches.—On November 25, 1977 the court entered the following order:

Neil B. Kabatchnick, attorney of record, for plaintiff.

Peter A. T. Sartin, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"This military pay case comes before the court on cross-motions for summary judgment. Plaintiff, a Marine, received orders to report for Vietnam duty on December 16, 1967. On December 14, 1967, while on home leave, he went to a local hospital and shot himself in the foot, causing permanent injury. He was court-martialed for malingering, 10 U.S.C. § 915 (1970), USMJ Art. 115, pleaded guilty, and was sentenced to dishonorable discharge, later reduced to bad conduct. He was discharged on January 3, 1969.

"Plaintiff now insists that his conviction and discharge were improper because he lacked the mental capacity necessary to commit the offense of malingering and to defend himself. This claim was first raised when he filed suit in the Court of Claims on December 23, 1974, a period of 5 years, 11 months, and 20 days after his bad conduct discharge. To try the issue of his mental capacity at the time of trial or at the time of his offense would now be a most difficult task, and the prejudice defendant would suffer from such a contest is obvious. No good cause explains this delay. We note that plaintiff was examined by psychiatrists both at the time of the offense and subsequently. Plaintiff's own counsel stated at the court-martial that plaintiff was mentally responsible. We hold that the doctrine of laches bars plaintiff's claim. *Brundage* v. *United States,* 205 Ct. Cl. 502, 504 F.2d 1382 (1974), *cert. denied,* 421 U.S. 998 (1975). It is unnecessary to address additional issues.

"Now, therefore, upon consideration of the motions, briefs, and oral arguments of the parties,

"IT IS ORDERED that defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied, and plaintiff's petition is dismissed."

Plaintiff's motion for rehearing, rehearing *en banc* and for other relief was denied February 3, 1978.

No. 179–75. NOVEMBER 25, 1977

Michael B. Stearsman

Military pay; court-martial conviction; service-connection; exhaustion of administrative remedies; right to privacy.—On November 25, 1977 the court entered the following order:

Joel M. Gora, attorney of record, for plaintiff. *Edward Brill* and *Poletti, Freidin, Prashker, Feldman & Gartner*, of of counsel.

Sandra P. Spooner, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant. *Julie P. Dubick*, of counsel.

Before DAVIS, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

"Plaintiff is a non-commissioned officer with the Air Force and has been continuously in the Service since 1956. Early in 1963, then a Staff Sergeant stationed at Eielson Air Force Base in Alaska, he was convicted by court-martial of having had sexual intercourse with a married woman not his wife. The woman was the wife of another Air Force sergeant stationed at the Base (the sergeant was a friend of plaintiff's), but the offense occurred at the other sergeant's house a considerable distance off the base. As a result of this court-martial conviction, plaintiff was (as finally determined) stripped of his sergeant's rank, reduced to the rank of Airman Basic, confined for five months and fourteen days, and compelled to forfeit pay and allowances during his confinement. After his return to duty late in 1963 he again rose through the ranks and at the time this case was submitted to the court he was either a Technical Sergeant or a Master Sergeant. The suit was brought on May 30, 1975, to collect back pay and other monies due as a

result of the court-martial which was alleged to have been invalid and wrongful, and for other relief. Both parties have moved for summary judgment and the case has been argued orally.

"Plaintiff's first point is that the court-martial was without jurisdiction because the off-the-base offense involving a civilian dependent of a serviceman was not service-connected, and therefore under *O'Callahan v. Parker*, 395 U.S. 258 (1969), could not have been tried by court-martial in 1963. This court has already rejected comparable arguments in *Augenblick v. United States*, 206 Ct. Cl. 74, 509 F.2d 1157 (1975), *cert. denied*, 422 U.S. 1007 (1975), and *Gross v. United States*, 209 Ct. Cl. 70, 79–80, 531 F.2d 482, 488 (1976), and we see no significant differences here.

"Plaintiff's second point is that his court-martial conviction on the charge of adultery violated his constitutional right of privacy which allegedly protects such sexual conduct between consenting adults. The majority of the court (Judges Kunzig and Bennett) hold that plaintiff is barred from raising this point in this court because he failed to raise it in the military justice system, either at the court-martial or on review within the military system. *See Schlesinger v. Councilman*, 420 U.S. 738, 756–58 (1975); *McKinney v. Warden*, 273 F.2d 643, 644 (10th Cir. 1959), *cert. denied*, 363 U.S. 816 (1960); *Harris v. Ciccone*, 417 F.2d 479, 484 (8th Cir. 1969), *cert. denied*, 397 U.S. 1078 (1970). Accordingly, those judges do not reach or consider the merits of the issue. Judge Davis, believing that military counsel could not be expected in 1963 to raise this right-to-privacy argument which has only recently been articulated and developed (*cf. Gross v. United States, supra*, 209 Ct. Cl. at 75–76, 531 F.2d at 486), would reach the merits of the point and reject it in the circumstances present here.[1]

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[1] The court-martial record shows that plaintiff and his partner in the adulterous act committed the act in the other sergeant's house, very near to his presence (he appeared to be sleeping on a nearby couch), and had a post-adultery conversation which was overheard by the sergeant. That sergeant worked on the same base as the plaintiff, and apparently the two were in frequent contact. In that particular set of circumstances, Judge Davis is of the view that plaintiff had no constitutional right-of-privacy protecting his adulterous act from military punishment. *Cf. Lovisi v. Slayton*, 539 F.2d 349 (4th Cir.), *cert. denied*, 429 U.S. 977 (1976).

"IT IS THEREFORE ORDERED AND CONCLUDED that plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted, and the petition is dismissed."

Plaintiff's petition for a writ of certiorari was denied May 22, 1978.

No. 215–75. NOVEMBER 18, 1977

Bernard Cameron

Civilian pay; dismissal; scope of review of administrative decision; Court of Claims jurisdiction; racial discrimination claim; penalty v. offense.—On November 18, 1977 the court entered the following order:

John I. Heise, Jr., attorney of record, for plaintiff. *Heise, Jorgenson & Stefanelli, P.A., Robert A. Hahn,* and *Sam Resnicoff,* of counsel.

Vincent M. Garvey, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before KUNZIG, *Judge,* Presiding, LARAMORE, *Senior Judge,* and BENNETT, *Judge.*

"This case, before the court on Cross-Motions for Summary Judgment, and Defendant's Motion to Strike Plaintiff's Exhibit 1, involves an alleged illegal removal of plaintiff from his position as an Air Traffic Control Specialist (GS–9) with the Federal Aviation Administration (FAA). Plaintiff seeks restoration of his position and back pay.

"Plaintiff was removed from his position with the FAA on the basis of an unsatisfactory attendance record. Alleging that his termination was the result of racial discrimination, plaintiff unsuccessfully contested his removal administratively, including an appeal to the Civil Service Commission (CSC). The CSC Board of Appeals and Review upheld the removal action. Plaintiff here claims that his removal was the result of racial discrimination, that the decision of the CSC upholding the removal was arbitrary and capricious, and the penalty of removal was so

disproportionate to the offense involved as to constitute an abuse of discretion.

"The scope of judicial review by this court in Federal employee cases is well defined. Judicial action is normally restricted to reviewing the administrative action so as to determine (1) whether there has been compliance with prescribed statutory and procedural requirements, and (2) whether the dismissal was arbitrary, capricious, so grossly erroneous as to imply bad faith, or not supported by substantial evidence. *Power v. United States*, 209 Ct.Cl. 126, 129–130, 531 F.2d 505, 507 (1976); *Boyle v. United States*, 207 Ct.Cl. 27, 34, 515 F.2d 1397, 1401 (1975); *Poschl v. United States*, 206 Ct.Cl. 672, 691–692 (1975); *Ricci v. United States*, 205 Ct.Cl. 687, 693, 507 F.2d 1390, 1393 (1974); *Grover v. United States*, 200 Ct.Cl. 337, 343 (1973); *Bielec v. United States*, 197 Ct.Cl. 550, 560–561, 456 F.2d 690, 696 (1972); *Morelli v. United States*, 177 Ct.Cl. 848, 858 (1966); *Liotta v. United States*, 174 Ct.Cl. 91, 95–96 (1966); and cases cited in the foregoing cases. As the court has stated, '[i]t is not our function to substitute our judgment for that of the employing agency or the Civil Service Commission; rather, we review the case to determine whether their action was reasonable in light of all the evidence.' *Boyle v. United States, supra*, 207 Ct.Cl. at 34, 515 F.2d at 1401; *Sakran v. United States*, 176 Ct.Cl. 831 (1966); *Harrington v. United States*, 174 Ct.Cl. 1110, 1116–1117 (1966); *Guiness v. United States*, 149 Ct.Cl. 1, 6, *cert. denied*, 363 U.S. 819 (1960). Similarly, the measure of the penalty, absent some showing of abuse, is within the discretion of the agency. *Grover v. United States, supra*, 200 Ct.Cl. at 353; *Birnholz v. United States*, 199 Ct.Cl. 532 (1972); *Heffron v. United States*, 186 Ct.Cl. 474, 484, 405 F.2d 1307, 1312 (1969); *Liotta v. United States, supra*, 174 Ct.Cl. at 96; *DeNigris v. United States*, 169 Ct.Cl. 619, 625 (1965).

"Plaintiff contends that his separation was not made to promote the efficiency of the service, but was effected, at least in part, because of racial discrimination. Assuming *arguendo* that this court has jurisdiction to hear cases where racial discrimination is but one element of arbitrary and capricious personnel action, the record in this case

does not support such an allegation. Plaintiff admits to the four occasions in which he was absent without leave, which are set forth in the Notice of Proposed Removal. Furthermore, the penalty of removal was consistent with the FAA's Table I Penalties for Delinquency or Misconduct.

"Having reviewed the administrative decision, we find that it is supported by substantial evidence, is neither arbitrary nor capricious, and is otherwise legally correct. Furthermore, there has been no showing that the agency abused its discretion in discharging plaintiff.

"IT IS THEREFORE ORDERED that defendant's Motion for Summary Judgment be and is hereby granted, that defendant's Motion to Strike Plaintiff's Exhibit 1 be and is hereby denied, that plaintiff's Motion for Summary Judgment be and is hereby denied, and that plaintiff's Petition be and is hereby dismissed."

No. 331-75. NOVEMBER 25, 1977

Puritan Associates; Parkway Terminal Company, Third-party defendant

Contracts; lease; breach; delays caused by Government; duty to disclose information; damages, proof of entitlement.—On November 25, 1977 the court entered the following order:

Laurence Schor, attorney of record for plaintiff. *Alan H. Kent* and *Max E. Greenberg, Trayman, Cantor, Reiss & Blasky,* of counsel.

Susan M. Linden, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant. *William P. Bennett,* of counsel.

Jack W. Plowman, attorney of record for third-party defendant. *John Guandolo, Macdonald & McInerny,* of counsel.

Before DAVIS, *Judge,* Presiding, COWEN, *Senior Judge,* and NICHOLS, *Judge.*

"This case is before the court on cross-motions for summary judgment, but the judgment sought by plaintiff is

partial only. A third-party, Parkway Terminal Company, was notified pursuant to Rule 41(a)(1) and its motion to quash the notice has been denied by order of May 13, 1977, 214 Ct. Cl. 735. Plaintiff was awarded a Lease/Build contract with the Postal Service. It was to purchase from defendant a tract of land then owned by Parkway Terminal Company, construct a postal facility on it, and lease the same back to defendant at an agreed rental. The location was in the Borough of Greentree, near Pittsburgh, Pennsylvania. The contract included no disputes clause and the claim is prosecuted on a breach theory. There are three alleged breaches, all of implied commitments. The first, which if sustained would subsume the others, is that well before the award date defendant knew of a record cloud on the title, namely what is hereinafter called the channel easement. This reflected a taking by the Department of Transportation, Commonwealth of Pennsylvania, made and recorded in 1950, to assure drainage for a state highway. Plaintiff was unaware of this easement and defendant, while notifying plaintiff of other title defects, failed to mention this. The easement, according to plaintiff, prevented necessary financing and thereby caused repeated postponements of the original agreed closing date, and the delays occasioned financial loss to plaintiff in the amount of $372,949. Plaintiff relies on the doctrine of *Hardeman-Monier-Hutcherson* v. *United States*, 198 Ct. Cl. 472, 458 F.2d 1364 (1972) and other cases, that in inviting bids defendant is obliged to disclose anything known to it, but likely to be unknown to bidders, that would materially delay performance or enhance its difficulty and cost.

"Defendant alleges various defenses. It relies on the title recording system of the state to impute prior knowledge of the easement to the plaintiff, but plaintiff says it was affirmatively misled. We can pass this issue by because of another defect in the claim, which defendant also relies on and which is decisive.

"The Lease/Build contract required plaintiff first to obtain title to the site by quitclaim deed of the defendant. It had to have good title to obtain necessary financing from private sources. Financial institutions would not lend in face of the title defect. Therefore, says plaintiff, the

defendant caused the delay by failing to clear the title of the channel easement as it should have done, and, therefore, it breached an implied contract not to obstruct the work. Defendant says it was able to clear the title almost immediately when the crucial nature of the defect was first called to its attention, so the cause of the delay must have been something else. Plaintiff has not shown what it was, and, therefore, has failed to establish that the defect was, in reality, the cause.

"Plaintiff was given an opportunity, at oral argument, to submit new affidavits clearing up this defect in its proof. They have been filed and considered, and fail to answer the real problem.

"A showing that the defendant's alleged dereliction could have caused the delay or was capable of doing so is not enough. It must appear that the delay, or at least some significant part thereof, was proximately caused by defendant, *i.e.*, would not have occurred if the delays for which defendant was responsible had been eliminated. *Merritt-Chapman & Scott Corp.* v. *United States*, 208 Ct. Cl. 639, 528 F.2d 1392 (1976). Since the defendant's contract did not embody a disputes clause, the issue formulated itself as a breach claim, whereas the cited case involved a suspension of work clause, but the principles are the same. Even if, as here, the assessment of damages is reserved for the quantum phase of the case, the plaintiff as part of its proof of entitlement, must show it was damaged to some extent, by defendant's derelictions, and it has failed to do so for the reason stated. One of plaintiff's post-argument affidavits makes the conclusory allegation that plaintiff's losses were the 'direct, sole, and proximate result' of the existence of record of the channel easement, but the detailed history of the case reveals the contrary.

"Defendant advertised for bids on November 5, 1970, and opened the bids on January 10, 1971. On April 20, 1971, it advised plaintiff an award would be made to it and entered into an 'agreement to lease' on the same date. Plaintiff was required to pay $373,700.41 for the land, and it was to receive $172,787 per annum for 20 years as rental. Closing was originally to be within 30 days, but the date was repeatedly extended.

"On May 7, 1971, the Lawyers Title Insurance Company called to plaintiff's attention the existence of record of the above-mentioned so-called 'channel easement.' On May 13, 1971, plaintiff by letter invited the attention of defendant to the existence of 17 exceptions (sic, actually 20) to the title as noted by the Title Insurance Company, of which that was one, but made no request with respect thereto except for extension of time. The channel easement was exception No. 14.

"Plaintiff had financing commitments but the leading institutions refused to permit closing until the title was cleared.

"On March 23, 1972, plaintiff's attorney wrote (referring to a conversation of evidently recent date) to the Army Engineers, which had assumed construction responsibility for the project. He stated that areas taken for the channel easement were located under a substantial portion of the proposed building, that lenders were unwilling to close, and that the location (perhaps he meant the exact location) was not known to plaintiff until the preceding week, 'when Gateway Engineers, Inc. indicated same on the Plan.' He thought the United States could easily obtain extinguishment of the right of way from the Commonwealth of Pennsylvania, since the Plan stated the involved areas were not in use since completion of an arch culvert. Defendant explains the easement was originally taken in 1950 to allow drainage from a state highway and that it had ceased to serve that purpose since installation of an arch culvert in 1965.

"Both plaintiff and defendant were thereafter in contact with the state. Defendant wrote the Pennsylvania Department of Transportation on March 28, 1972. On May 25, 1972, the Pennsylvania District Engineer executed a notice that except for the culvert, the channel easement had become unnecessary and it was, therefore, abandoned. This enabled the closing to take place, as it did, the following day, May 26, 1972.

"Defendant of course had long been aware of the channel easement and plaintiff, as has been said, became aware on May 7, 1971. The letter of March 23, 1972, indicates that until shortly before that date, plaintiff or its counsel had

not seen the easement plotted on the plan and therefore did not realize the extent to which it was a cloud on the title. There is nothing to show that defendant did not likewise lack this realization. It is clear that since building of the culvert in 1965, the easement had been of no value to the state. There is nothing to show that the state would not have abandoned the easement, except for the culvert, whenever asked, at any time after 1965.

"Plaintiff would like to have us believe, and hold, that the defendant should have extinguished the channel easement at the time of inviting bids, or before, and that its failure to do so (not having advised plaintiff of the defect before it bid) was a breach of implied obligations, and caused the refusal of the financing institutions to go to closing, the repeated postponements of the closing date, and the delay losses plaintiff suffered.

"It is obvious that the plaintiff at the outset, and throughout, did not ask defendant to remove title defects. It worked on them itself (several others besides the channel easement) and asked for time extensions when difficulty arose with them. It did not ask for defendant's help on the channel easement, departing from its previous course of dealing, until March 23, 1972, almost a year after the award date. The channel easement was a matter of appearance, not substance. It could have been removed on request at any time. All parties seem to have been late in tumbling to its significance as a stumbling block to early closing.

"It seems clear that responsibility for delay up to March 23, 1972, cannot be imputed to the channel easement itself, whose significance no one realized, and, therefore, it fails as a vehicle for charging defendant with causing that delay. As to the period after March 23, 1972, it appears that on or before April 25 plaintiff's counsel had learned that Pennsylvania would release the channel easement. He asked for a time extension to May 31. The extended time was almost all used, but there is nothing to show Pennsylvania would not have met an earlier deadline. Assuming, however, that it took two months to get a release out of the state bureaucracy, once it was asked for, plaintiff, or defendant at plaintiff's request, could have

easily accomplished it, so far as appears, within the delay caused by other things, well before March 23, 1972. Plaintiff, who knew of the channel easement as early as May 7, 1971, and could with diligence have had it extinguished within 60 days thereafter, either by its own request alone or one supported by defendant, cannot use the channel easement to blame defendant for the delay from March 23 to June 26, 1972, which is the most it can be considered to have caused. Accordingly, plaintiff's breach claims fail so far as they relate to the channel easement.

"Plaintiff had two other alleged breach claims. One related to an alleged misdescription. The quitclaim deed gave the western property line of the site as 483.73 feet, while the Agreement to Lease gave it as 439.73 feet, but the latter was eventually corrected to agree with the former. This minor discrepancy cannot be rationally said to have caused all or any part of the delay of over a year in effecting a closing. The other relates to the failure of Parkway Terminal Company to complete Turnbull Drive until December 1971, that drive having to be crossed for access to the project site. Defendant says that the drive, even when incomplete, offered no impediment to plaintiff's crossing it, and in any event, plaintiff was not ready to close until long after the drive was completed. We conclude that both these matters lack standing as independent breaches that require consideration even if, as we hold, the channel easement claim fails. Plaintiff hardly attempts to argue otherwise.

"Accordingly, upon consideration of the motions for summary judgment, the briefs, affidavits, and documents submitted in support thereof, and the oral arguments of counsel, IT IS ORDERED, that plaintiff's motion for partial summary judgment is denied, defendant's motion for summary judgment is granted, and the petition is dismissed."

No. 240–76. NOVEMBER 25, 1977

Anthony J. Perlongo

Civilian pay; dismissal; probationary employee; standard of review of agency action.—On November 25, 1977 the court entered the following order:

Robert A. Hahn for plaintiff; *John I. Heise, Jr.*, attorney of record. *Sam Resnicoff*, of counsel.

Stephen G. Anderson, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before NICHOLS, *Judge*, Presiding, LARAMORE, *Senior Judge*, and KASHIWA, *Judge*.

"This case is before this court on defendant's motion for summary judgment and plaintiff's cross motion for summary judgment. Plaintiff is seeking back pay, an order of reinstatement, and correction of his records to reflect continuous service. After consideration of the briefs and oral arguments, we hold plaintiff is not entitled to the relief requested.

"Plaintiff, Anthony J. Perlongo, joined the Drug Enforcement Agency (hereinafter referred to as DEA) on September 2, 1975, as a special agent trainee under a career-conditional appointment. Plaintiff's employment was to be probationary for a period of one year. During the tenth week of the probationary period, plaintiff was terminated by the DEA for the following reasons:

> On the basis of evaluations and appraisals of your conduct and performance while on duty during special agent training which began on September 8, 1975 it has been determined that you have not demonstrated character traits necessary for satisfactory performance as a Career employee. Staff officials of the Drug Enforcement Administration National Training Institute who have counselled you and observed and evaluated your conduct and performance have indicated that you have been uncooperative, argumentative, you lack self discipline and you are unable to accept constructive criticism. In addition, it was reported by training officials that you lack the ability to apply to realistic field training situations those principles and techniques which were taught in the

> academic portion of training such as inability to perform satisfactorily in a simple surveillance situation.

Plaintiff contends that the termination is both procedurally and substantively defective.

"As a probationary employee, plaintiff is entitled to administrative review of his dismissal only to the extent provided by the regulations of the Civil Service Commission. The Lloyd-LaFollette Act, 5 U.S.C. § 7501 (1970), does not apply to probationary employees because they are not members of the classified civil service. *Powers* v. *United States*, 169 Ct. Cl. 626, 629 (1965); *Day* v. *United States*, 143 Ct. Cl. 311 (1958). The Veterans' Preference Act, 5 U.S.C. § 7512 (1970), does not apply to probationary employees because they are expressly excluded from the definition of 'preference eligible employees' to whom the act does apply. 5 U.S.C. § 7511 (1970). Moreover, there are no regulations of the DEA which broaden the rights conferred by the Civil Service Commission in 5 C.F.R. § 315.801 (1975) *et seq.* Accordingly, plaintiff may not contest his dismissal except to the extent that rights conferred by 5 C.F.R. §§ 315.801 (1975) *et seq.* were violated by the DEA. *Kaufman* v. *United States*, 207 Ct. Cl. 1005 (1975).

"The rights conferred by Civil Service Commission regulations are very narrow. Procedurally, a probationary employee has the right only to be notified prior to termination of his employment as to the agency's 'conclusions as to the inadequacies of [the probationer's] performance or conduct.' 5 C.F.R. § 315.804 (1975); *Horne* v. *United States*, 190 Ct. Cl. 145, 148, 419 F. 2d 416, 418 (1969). Substantively, the only limitation on an agency's power to dismiss a probationary employee is that the agency must honestly be dissatisfied with the probationer's conduct or performance after giving him a fair trial at the job. *Horne* v. *United States*, *supra* at 150, 419 F. 2d at 419; *Dargo* v. *United States*, 176 Ct. Cl. 1193, 1206 (1966).

"Here, no procedural defect in effecting plaintiff's separation has been shown. The DEA officials clearly complied with the Civil Service regulation. Plaintiff was verbally notified by DEA officials of the reasons for his termination in an exit interview on November 12, 1975.

Further notification was provided in a letter dated November 13, 1975, which also advised plaintiff of his appeal rights.

"Substantively, plaintiff contends the stated reasons for his termination were not the true and correct reasons. Plaintiff maintains that the real reason for his termination was because he had reported one of his instructors for drinking while on duty. This caused a majority of the instructors to adopt a vindictive attitude toward him which eventually led them to recommend his termination.

"In reviewing this substantive issue, our inquiry is whether DEA's action represents its honest judgment. Here, the record shows there is substantial evidence and a rational basis for the action taken by the DEA officials. Plaintiff's conduct in reporting instructor Rochon's drinking while on duty is only one of a number of incidents which brought plaintiff's character into question by the DEA officials. Further, plaintiff has alleged facts showing possible bias on the part of only one of the eight instructors who voted to terminate him. The other seven must be presumed to have acted in good faith in voting for his termination. *Knotts* v. *United States*, 128 Ct. Cl. 489, 121 F. Supp. 630 (1954). These seven would still constitute a majority of the instructors and would have led to the recommended termination of plaintiff. Also, the action of the supposedly biased instructors was only a recommendation to higher officials. Two higher officials had to review the recommendation of termination and act on it before plaintiff was terminated. Plaintiff alleges no bias on the part of the higher officials.

"Finally, one of the required tasks of a narcotics agent is to observe actions and conduct and submit detailed, accurate reports thereon. Plaintiff's conduct in writing the October 23, 1975, memorandum attacking instructor Rochon's character with a barrage of unsupported and slanderous charges—that the instructor was an alcoholic, unworthy to be a special agent, one who took delight in criminally and sadistically abusing an informant—raises grave questions about his ability to dispassionately observe events and accurately report them to his superiors. Therefore,

"IT IS ORDERED that plaintiff's cross motion for summary judgment is denied; defendant's motion for summary judgment is granted; and the petition is dismissed."

Plaintiff's petition for a writ of certiorari was denied June 5, 1978.

No. 337-76. NOVEMBER 25, 1977

Media Press, Inc.

Contracts; requirements contract; exceptions clause.—On November 25, 1977 the court entered the following order:

William A. Bradford, Jr., attorney of record, for plaintiff. *Edgar W. Holtz*, and *Hogan & Hartson*, of counsel.

Susan M. Linden, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant. *Drew Spalding*, Government Printing Office, of counsel.

Before KUNZIG, *Judge*, Presiding, LARAMORE, *Senior Judge*, and BENNETT, *Judge*.

"This case comes before the court on cross-motions for summary judgment on the issue of contractual liability. The case has been submitted on the briefs and oral argument of counsel.

"The present dispute arises out of a contract for the procurement of certain printed forms by the Government Printing Office (hereinafter referred to as "GPO") on behalf of the Department of Health, Education and Welfare. Multiple awards were made because it was anticipated that no single printing firm would be able to meet all of the agency's needs. The solicitation asked for bid prices on four variables, one of which was 'folding'. The other variables were (1) white paper, (2) colored paper, and (3) address imprints. Plaintiff was named low bidder on the basis of its aggregate low price, with the other awards made sequentially from lowest to highest, also on the basis of aggregate prices. In placing work, the GPO was obligated to first communicate with the low contractor to determine whether or not he could accept an order. The only valid reason for declining was inability to meet a shipping schedule. If the low contractor was unable to accept an

order, the Government would contact the next low bidder, and so on, until the job was accepted.

"The contract provided three exceptions to this method of placing work, only one of which is pertinent here. The provision in question, Exceptions Clause (3), reserved the right to establish a new low bidder and numerical sequence of other bidders on each particular print order, taking into account only those variables involved in that particular order, rather than on an aggregate basis taking into account all four variables. This process of computing prices on each individual print order is known as 'abstracting'. Abstracting showed, because of the structure of plaintiff's bid, that on orders requiring little or no folding, the prices of other contractors were lower. The Government invoked this exception with the result that all orders were not automatically offered initially to plaintiff. Plaintiff sues here for lost profits on these print orders.

"Plaintiff claims that the contract here in issue was a requirements contract and that each failure on the part of the defendant to offer it a print order constitutes a breach. A requirements contract has been defined as a contract in which the purchaser agrees to buy all of its needs of a specified material from a particular supplier, and the supplier agrees, in turn, to fill all of the purchaser's needs during the period of the contract. *Inland Container, Inc. v. United States*, 206 Ct. Cl. 478, 482–483, 512 F.2d 1073 (1975); *Ready-Mix Concrete Co., Ltd. v. United States*, 141 Ct.Cl. 168, 169, 158 F.Supp. 571 (1958); *Gemsco, Inc. v. United States*, 115 Ct.Cl. 209 (1950); *Johnstown Coal & Coke Co. v. United States*, 66 Ct.Cl. 616 (1929). Neither party to the instant contract is so tightly and exclusively bound to the other so as to give rise to a requirements-type arrangement. The government retained the right to purchase some of its needs from other printers. Similarly, plaintiff was empowered to refuse orders if it was unable to meet a delivery schedule. We conclude, therefore, that such consideration is insufficient to support plaintiff's construction of the contract as a requirements contract. *See, Goldwasser v. United States*, 163 Ct.Cl. 450, 454–455, 325 F.2d 722, 724 (1963)

"Plaintiff also contends that the Government made improper use of Exceptions Clause (3) of the contract. It is plaintiff's position that the exceptions clause is to be interpreted so as to be invoked by the Government on rare occasions and only then to deal with abusive contractors. However, the plain language of the clause convinces us that it was intended to be employed as a cost-cutting measure. That the government made use of the exceptions clause as often as it did, is a direct result of the structure of plaintiff's aggregate bid. Where, as here, plaintiff was initially offered more than a majority (although we do not posit this as a test) of the work under the contract, it is not inconsistent to describe the clause in question as an exception.

"For the foregoing reasons, IT IS ORDERED that plaintiff's motion for summary judgment be and is hereby denied, defendant's motion for summary judgment be and is hereby granted, and plaintiff's petition be and is hereby dismissed."

No. 66-77. NOVEMBER 25, 1977

Sherman W. Pratt

Military pay; disability pay; laches.—On November 25, 1977 the court entered the following order:

Sherman W. Pratt, pro se.

Lynn J. Bush, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"Plaintiff, a former infantryman, served in the Army from 1939 until 1959 when he was retired for longevity under the provisions of 10 U.S.C. § 3911 (1970). He now claims that, unknown to the Army, he was then suffering from disabled feet and should have been retired for disability. We have the case on cross-motions for summary judgment.

"Plaintiff was offered, but declined, an opportunity to undergo disability examination at the time of his retire-

ment. His final service physical examination revealed no problem with his feet. Plaintiff has not shown us that he ever complained of any problem with his feet until 1974, although it may first have been raised in 1971. He did not file suit until 1977. Plaintiff's case is clearly barred by the doctrine of laches. *See Devine* v. *United States*, 208 Ct. Cl. 998 (1975).

"Therefore, upon consideration of the motions and the written and oral arguments of the parties,

"IT IS ORDERED that plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted, and plaintiff's petition is dismissed."

No. 214–73. DECEMBER 9, 1977

Nolan Lapeyrouse and Charles Lapeyrouse

Court of Claims jurisdiction; oyster growers; lease from Government; damages from dredging operations; damage not permanent; superceding event extinguishing Government future liability.—Plaintiffs are the holders of a 15-year, renewable term lease of water bottoms granted them by the Wild Life and Fisheries Commission of Louisiana, for the conduct of a commercial oystering operating in Lake Borgne. As a result of channel dredging operations undertaken by the Corps of Engineers beginning in September 1971, 125 acres of plaintiffs' oyster lease were subjected to a build-up of mud and grass which, in turn, destroyed the existing oyster crop. Plaintiffs seek damages under 28 U.S.C. § 1497; liability has been admitted by the United States. In a recommended decision filed May 23, 1977, Trial Judge John P. Wiese found that as a result of the channel dredging operations the existing oyster crop was destroyed; however, this damage was not permanent in nature. Through the influence of natural forces, the firm bottom necessary for the resumption of oyster growth would have been restored within a period of approximately 30 months, that is, by the end of March 1974. Thus, absent other considerations, the United States would be required to respond in damages for this full 30-month period plus such additional time as might then remain necessary to

allow for completion of crop maturation. However, in this case, a superceding event, namely the opening of the Bonnet Carre Spillway in April 1973 extinguishes the Government's liability for any damages thereafter occurring. The injurious effects of the Spillway opening upon plaintiffs' oyster lease are not factually connected with the damage caused by the dredging operation, are, in and of themselves, not compensable by statute, and continued to adversely influence growing conditions on plaintiffs' lease well past the time that full recovery from the dredging operations could have been expected. Accordingly, plaintiffs are entitled to damages for loss of oyster crops from the time damage first manifested itself, October 1971, until the time of the Spillway opening, April 1973. For this 18-month period plaintiffs are due $16,021.13. This case came before the court on plaintiffs' exceptions to the said recommended decision. Upon consideration thereof, the court, by order entered December 9, 1977, affirmed and adopted the said decision as the basis for its judgment in this case, concluded that plaintiffs are entitled to recover, and entered judgment for plaintiffs against defendant for $16,021.13.

No. 426-73. DECEMBER 16, 1977

Hughes Aircraft Company

Pleading and practice; trial judge; disqualification of.—On December 16, 1977 the court entered the following order (as amended by order entered February 3, 1978):

Dugald S. McDougall, attorney of record for plaintiff. *Keith V. Rockey*, *John A. Sarjeant*, and *John E. Benoit*, of counsel.

Thomas J. Byrnes, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant. *James D. Stokes, Jr.*, of counsel.

Before DAVIS, *Judge*, Presiding, COWEN, *Senior Judge*, NICHOLS, KASHIWA, KUNZIG and BENNETT, *Judges*, *en banc*.

"This case is before the court on defendant's request for review of a determination by the Chief of the Trial Division

under Rule 14(d). We heard oral argument *en banc* and our conclusion is that the determination must be vacated. Our order herein is substituted in lieu thereof.

"The litigation seeks to establish Government liability and to obtain reasonable and entire compensation under 28 U.S.C. § 1498, for use of an invention described or covered in a patent, without license of the owner thereof. On December 15, 1975, the case was transferred to the then newly appointed Trial Judge Francis C. Browne as part of the administrative distribution of the patent case workload among our two patent trial judges. He has handled it ever since. A trial has been conducted and proof closed. The parties have submitted their requested findings and briefs, but no recommended decision has been made.

"Rule 14(d) is concerned with removal of a trial judge from a case for 'personal bias or disqualification.' Defendant moved under it on July 15, 1977, for an order disqualifying Judge Browne. There is no affidavit of bias or prejudice as the rule calls for, but that rule cannot be followed where, as here, the moving party does not contend the trial judge is biased or prejudiced, only that he is legally disqualified. It is agreed by both parties that he has no bias or prejudice for or against either party. As to this, no other conclusion would be possible. But now, more than ever, disqualification may be mandatory on technical grounds that have remote if any connection with any unfitness to adjudicate the case, due to real bias or prejudice.

"Before his appointment as our trial judge on December 15, 1975, Judge Browne had been in private practice for many years in the patent bar, in which he was well known as an expert. He was never personally connected with the instant case. But William E. Schuyler, Jr., Esq., was his partner from 1951 to 1969. During that period, in mid-1966, the plaintiff company consulted Mr. Schuyler concerning the claims of the as yet unissued Williams patent, (now No. 3,758,051) the claims of the previously issued original McLean patent (No. 3,216,674) and the fact that the patent examiner had cited the latter in connection with the application for the former. Mr. Schuyler advised plaintiff that in his opinion there were unnecessary limitations in

the original McLean patent which could be eliminated by the timely filing of an application for a reissue patent, and if the limitations were eliminated, its claims would dominate the Williams claims. He recommended that plaintiff acquire the rights to the original McLean patent and seek a determination whether it could be reissued. There is no claim that this was improper advice and Mr. Schuyler was not the one who carried it out. He did not appear in the patent office proceedings. But he is an important witness in the case. Plaintiff did do as advised, and is suing here for infringement of the Williams patent. Defendant claims invalidity through an affirmative defense which sets up that the Williams patent is unenforceable because of alleged misconduct of plaintiff in failing to disclose to the patent examiner the facts and circumstances relating to the prosecution of the application for and the issuance of the reissue McLean patent.

"Mr. Schuyler's testimony is by deposition. It is not disputed and perhaps it could have been stipulated, but the fact remains it is in the case as testimony.

"Trial Judge Browne on first taking the case raised with counsel another possible ground for disqualification, not here involved. Mr. Schuyler's connection was not then known. It came into the case by the testimony of plaintiff's patent agent, Noel B. Hammond, in a deposition on January 21 and 23, 1976. The development was disclosed to Judge Browne on February 4, 1976, and by memorandum of February 6, he indicated that the parties might depose Schuyler and, if they did, his (Browne's) disqualification would be considered at a later date. On April 8, 1976, Mr. Schuyler was deposed. Defendant, by letter of June 8, 1976, indicated that Schuyler's name was and would in the future be in the case, and whether this concerned Browne was left to his discretion. On June 15, 1976, Browne indicated in a conference memorandum that he had discussed his disqualification with counsel, but in the absence of an indication by counsel for either side, that there was 'any appearance of impropriety' in his continuing in the case, he would not ask for its transfer. Trial was thereafter conducted.

"On May 5, 1977, in connection with its post-trial submissions, defendant for the first time suggested recusal, saying that 28 U.S.C. § 455(b)(2) mandated it. That amendment to § 455 of the Code was approved December 5, 1974, Pub.L. 93–512, 88 Stat. 1609. Defendant states that this amendment had been unknown to defense counsel until shortly before May 5, 1977. Plaintiff continued to assert then and thereafter (as it did before us) that the amended statute did not apply. Defendant filed its pending motion for disqualification on July 15, 1977. The intervening communications need not be detailed as we deem them not relevant.

"Few things Congress ever said or did attracted more attention by sitting Federal judges than the above legislation in its progress towards enactment, but we cannot assume that what was important to us was equally important to others. The presumption that official actions are taken in good faith is a strong one. *Knotts* v. *United States*, 128 Ct. Cl. 489, 492, 121 F.Supp. 430 (1954). We must and do, therefore, conclude that defendant really did not discover the statute until the time it says it did. Its disposition to judge charitably now is tempered by its concern about possibly getting a void decision. It will have to live with the suspicion of others, which we do not say is well founded, that it kept its blockbuster under wraps until the time arrived to explode it with maximum disruptive effect. Our duty is to follow the law without regard to considerations of that kind. The court is now required to engage in self-policing, in which the conduct and motives of the parties are irrelevant.

"We deem this case is governed by the concurrent application of the above statute and of the Code of Judicial Conduct for United States Judges. The Code of Judicial Conduct is the earlier in time so we quote it first:

C. *Disqualification*

> (1) A judge shall disqualify himself in a proceeding in which his impartiality might reasonably be questioned, including but not limited to instances where:
>
> * * * * *

(b) he served as lawyer in the matter in controversy, or a lawyer with whom he previously practiced law served during such association as a lawyer concerning the matter, or the judge or such lawyer has been a material witness concerning it; [69 F.R.D. at 277]

The statute, cited *supra*, reads:

§ 455. Disqualification of justice, judge, magistrate, or referee in bankruptcy.

(a) Any justice, judge, magistrate, or referee in bankruptcy of the United States shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned.

(b) He shall also disqualify himself in the following circumstances:

* * * * *

(2) Where in private practice he served as lawyer in the matter in controversy, or a lawyer with whom he previously practiced law served during such association as a lawyer concerning the matter, or the judge or such lawyer has been a material witness concerning it;

* * * * *

There is also for consideration the effective date provision, Section 3, which reads as follows:

Sec. 3. This Act shall not apply to the trial of any proceeding commenced prior to the date of this Act, nor to appellate review of any proceeding which was fully submitted to the reviewing court prior to the date of this Act.

And it was approved as stated, December 5, 1974. This was after the petition was filed, but before the trial began, in the case before us. The antecedent of the word "commenced" is unclear, because of which there may be some ambiguity in the statutory language, as applied to the facts herein, but the legislative history resolves it. House Report No. 93–1453, 93d Cong., 2d Sess., entitled JUDICIAL DISQUALIFICATION, reads as follows at 12, 3 U.S. CODE CONG. AND ADM. NEWS (1974) 6351, 6362:

Section 2 [the present 3] makes the bill inapplicable to trials commenced and to appellate matters which

> were fully submitted prior to the effective date of this Act.

Under date of April 23, 1975, Carl H. Imlay, Esquire, General Counsel to the Administrative Office of the United States Courts, sent a memorandum to ALL FEDERAL JUDGES AND UNITED STATES MAGISTRATES, in which he commented on Section 3 at p. 9. He quoted the above language and went on:

> This language appears to clarify that the law's disqualification provisions were intended to apply in those district court cases filed prior to December 5, 1974, so long as the trial in the case did not commence until after that date. The legislative intent appears to be that the new standards of disqualification should apply as fully and immediately as possible without the interruption of ongoing trials.

He included us in his distribution and there is no reason to doubt that the term 'district court' as used by him is not exclusive of us. This is not exactly the conventional case of contemporary administrative construction of a statute, but many of the same reasons for respecting it apply. He had ample reason to be well acquainted with the legislative intent, having closely monitored the whole progress of the statute. We conclude that the statute applies to this case because, though filed before December 5, 1974, trial had not then begun. The court in *In re Virginia Electric & Power Co.* v. *Sun Shipbuilding & Dry Dock Co.*, 539 F.2d 357 (4th Cir. 1976), comes to a contrary conclusion to ours, but only as an alternative ground. It does not advert to the legislative history or Mr. Imlay's memorandum.

"This court expressly made the statute applicable to our trial judges, by our General Order issued January 6, 1975.

"There is, however, no reason to treat the Code of Judicial Conduct as preempted. The Judicial Conference does not take this view, for it has amended the Code since the Act in a manner that assumes its continued vitality. The report cited, *supra*, at 12, 3 U.S. CODE CONG. AND ADM. NEWS (1974) at 6361, indicates that the Congress wanted both to run parallel, to eliminate the confusion that would exist if the statute and the Code of Judicial Conduct were different, as they were up to December 4, 1974, far more

widely than since. In an instance, such as this does not appear to be, of different standards, the stricter one would control.

"The statute differs from the Code of Judicial Conduct, in that the statute eliminates an ambiguity some have found in the Code, reading specific disqualifications such as the one for prior service of a partner, here involved, as effective only where the judge's impartiality might reasonably be questioned. The statute corrects this, as it cannot be so read. In any event, this construction of the Code of Judicial Conduct is mistaken as it would frustrate the whole object the Judicial Conference had in mind. This was, so far as possible, to eliminate instances where disqualification was to be decided according to the judge's own subjective determination whether his impartiality could reasonably be questioned, looking into his own heart and observing it to be pure. The interpretation we reject would perpetuate this unsatisfactory situation.

"In *Kesselhaut* v. *United States*, 214 Ct. Cl. 124, 555 F.2d 791 (1977), we held that in a disqualification context (there a former government attorney) the word 'matter' carried disqualifying participation back from the lawsuit itself to the transactions in which the issues litigated had their origins. This part of that decision is considered more extensively in the order of Trial Judge Schwartz that we had under review. The word 'matter' has the same meaning here. Both statute and Code of Judicial Conduct use the phrase 'matter in controversy.' Plaintiff says that Mr. Schuyler is not involved in controversy, in that his testimony is not controverted, and his advice, as testified to, is not challenged by anyone as wrongful. This interpretation of the language did not impress the Fourth Circuit, *In re Rodgers*, 537 F.2d 1196 (1976). A rule of reason might be urged where the involvement as attorney or witness concerns only some petty or insignificant act, as, *e.g.*, having mailed a letter. Mr. Schuyler's involvement is not of that character. A fine analysis of the precise nature of it, and efforts to guess the extent, if at all, to which it might influence the trial judge's mind, would bring speculative and subjective considerations into play, which the statute

and the Code of Judicial Conduct seek to banish from the area.

"It is unfortunate that the impact of the new standards in this case may impose added cost and delay upon the parties, added expenditure of judicial resources by this court, and the loss of work already performed. These evils can be reduced or eliminated, in the future, if everyone acting in a judicial capacity gives affirmative consideration to the Code of Judicial Conduct and the statute, separately with respect to every case, as to which he is asked to take any kind of action, and without waiting for moves by the parties. Nothing less than this will suffice. Both the Judicial Conference and the Congress undoubtedly took notice of the normal ease of substitution, by designation if necessary in the Federal system, when the problem is seen and acted on promptly. Since we have only two patent trial judges in our establishment, the situation is as tight here as it is likely to be anywhere. It may be hoped that with experience in the future, it will be possible to spell out objective standards that will not be overbroad, and will not disqualify in so many instances where impartiality could not reasonably be questioned, as here. That is not the case at present, and is the reason why one's own consciousness of purity of heart cannot be a safe guide by itself. Here we must remove from a case one of the few qualified experts available to us in a complex and esoteric field, on account of technical disqualification, although no one challenges his impartiality, and the facts suggest no reason why anyone should. Yet we remember the few unhappy incidents that instigated a morbid and growing disbelief in the integrity of the Federal judiciary, and we cannot fault the efforts on the part of the Judicial Conference and the Congress to correct the situation. We hope that this and other inevitable hard cases will bring about a continued study of the problem. Neither the Judicial Conference nor Congress can put it aside as disposed of. Meanwhile, there is nothing for us to do but abide by the rules that have been given us.

"The Imlay memorandum raises, without answering, a question whether a failure to abide by the statute might produce a decision void for lack of jurisdiction. Defendant

has the same concern. We need not answer the question here, but advert to its existence as further mandating exact and literal compliance.

"Whether the new trial judge is to base his decision on the existing record must be left to his discretion. The defendant we consider has estopped itself from even asking any reopening of the proofs, and we do not accord the plaintiff that privilege as of right. If the proofs are reopened to allow plaintiff to introduce new evidence, defendant of course may offer rebuttal evidence.

"Trial Judge Browne, since oral argument but before we had announced our decision, indicated he now desires to recuse. Since he has not actually done so, the matter is not moot. We further consider this order necessary under our supervisory responsibilities.

"Accordingly, review of the trial judge's determination is granted, said determination is vacated, and the Chief of the Trial Division is directed to transfer the case forthwith to another trial judge."

No. 259-76. DECEMBER 16, 1977

Allen Aaron Jackson

Military pay; enlistment contract; remand from Supreme Court.—On December 16, 1977 the court entered the following order:

Before KUNZIG, *Judge,* Presiding, and BENNETT, *Judge.*

"This case comes before the court on decision and remand of the Supreme Court, that Court having on November 14, 1977, entered orders granting the petition therein for a writ of certiorari and adjudging that the judgment of this court in this cause be vacated with the cause remanded for further consideration in accordance with the order of remand. (434 U.S. 947)

"IT IS THEREFORE ORDERED that, in conformity with the said decision and remand of the Supreme Court, filed in this court on December 15, 1977, the judgment entered in this case by this court on March 23, 1977, 213 Ct.Cl. 354, 551 F.2d 282, be and it is vacated and withdrawn with further proceedings in this court to be held in light of the position asserted by the Solicitor General in his brief filed

in the Supreme Court on October 25, 1977 (Supreme Court No. 77–277).

"Pursuant to the mandate of the Supreme Court, the parties may wish to make further submissions to this court on any issues involved in the case and particularly on the definition of basic combat training as may be defined by Army regulations and plaintiff's performance thereunder. Also, counsel may wish to address the issue of whether the enlistment contract mandated training exclusively in plaintiff's designated military occupational speciality immediately upon completion of such training within the interpretations which have been given, if any, to DA Form 3286–47 R, Part VI, Sec. 1, par. 1(c) and Part I, par. 1(f).

"IT IS THEREFORE FURTHER ORDERED that counsel may have 30 days from the date of this order, running concurrently, in which to make any additional submissions they may wish to submit to the court, and that thereafter they may have 15 days in which to respond thereto, the time for responses also to run concurrently."

See opinion of the court filed March 22, 1978, dismissing petition, reported at 216 Ct.Cl. 25, 573 F.2d 1189.

No. 344–76 ETC. DECEMBER 16, 1977

Anderson Snapper Boats, Inc., etc.

Pleading and practice; reference of procedural order; request for prompt review; motions to suspend and for enlargement of time; employee-independent contractor.—On December 16, 1977 the court entered the following order:

Joseph J.Lyman, attorney of record, for plaintiff.

W. C. Rapp, with whom was *Assistant Attorney General M. Carr Ferguson,* for defendant.

Before DAVIS, *Judge,* Presiding, NICHOLS and KASHIWA, *Judges.*

"The defendant has in effect requested, via a motion to suspend and motion for enlargement of time, that all proceedings in the captioned cases be suspended pending our resolution of the motion for summary judgment in the *Bill Wells* case, No. 504–76. Trial Judge Browne denied the

motions on November 9, 1977, and set all the cases for trial commencing February 13, 1978, and continuing, *seriatim*, through March 13, 1978. Defendant is now seeking prompt review of Trial Judge Browne's November 9, 1977, order pursuant to Rule 53(c)(2)(ii).

"A complicating factor is that there are three other cases presently pending before other trial judges. *Donna Jean, Inc.* v. *United States*, No. 105–77, is pending before Trial Judge White. In that case Trial Judge White denied the defendant's motion to suspend without prejudice should the parties subsequently agree that the decision in *Bill Wells* be binding. *Leonard* v. *United States*, No. 121–77, and *Litrico* v. *United States*, No. 517–77, are pending before Trial Judge Yock. Trial Judge Yock suspended proceedings in *Leonard*. No such action has been taken in *Litrico;* however, *Litrico* was just recently filed (October 17, 1977).

"All the above cases involve withholding tax, unemployment tax, and social security tax questions and the duty of the employer to collect and pay the taxes over to the Internal Revenue Service. I.R.C. §§ 3101, 3111, 3301, and 3402. The controlling issue in all is whether the fishermen in each case are employees or independent contractors.[1] The factual setting of all these cases also is quite similar, although not identical.

"The defendant has selected another case, *Bill Wells, Jr., T/A Wells Shrimp Co.* v. *United States*, No. 504–76, involving the same questions, issue, and factual pattern, for a test motion for summary judgment. The motion for summary judgment in that case and the plaintiff's objection thereto have been filed with the clerk's office as of December 6, 1977. Fifteen days from December 6, 1977, the defendant's reply brief is due. Rule 52(b)(2). After that, assuming no extension of time is requested or granted, the summary judgment motion in *Bill Wells* will be ready for our consideration.

"We note that none of the plaintiffs in the captioned cases nor the plaintiff in *Donna Jean, Inc.* v. *United States, supra*, have agreed to be bound by the decision in *Bill*

[1] The discrimination and estoppel issues raised by some of the plaintiffs were severed from the employee/independent contractor issue pursuant to our order of November 18, 1977.

Wells. Despite this and the factual nature of the employee/independent contractor issue generally, we feel judicial economy requires the granting of the motion to suspend and motion for enlargement of time pending our resolution of the defendant's motion for summary judgment in the *Bill Wells* case. We hold this to be especially true in the captioned cases for the plaintiffs did not oppose such action before Trial Judge Browne. However, we feel that defendant's request for 60 days beyond our resolution of the summary judgment motion in *Bill Wells* is needlessly dilatory, as the plaintiffs contended before Trial Judge Browne. Therefore,

"IT IS ORDERED that defendant's request for prompt review be and hereby is granted. Further, it is ordered that defendant's motion for enlargement of time in Nos. 362–76, 371–76, 372–76, 456–76, 502–76, and 516–76 pending our resolution of the summary judgment motion in *Bill Wells, supra,* be and hereby is granted. It is further ordered that defendant's motion to suspend proceedings in Nos. 344–76, 345–76, and 503–76 pending our resolution of the summary judgment motion in *Bill Wells* be and hereby is granted. The defendant's request in both motions for 60 days beyond our resolution of the summary judgment motion in *Bill Wells* is hereby denied."

No. 87–75.—JANUARY 6, 1978

Henderson Clay Products, Inc.

Taxes; income tax; deductions; depletion allowance; proper method of determining constructive gross income from mining.—On January 6, 1978 the court entered the following order:

John G. Heard, attorney of record, for plaintiff. *Thomas P. Marinis, Jr., Glen A. Rosenbaum,* and *Vinson & Elkins,* of counsel.

Allan C. Lewis, with whom was *Assistant Attorney General M. Carr Ferguson,* for defendant. *Theodore D. Peyser* and *Robert S. Watkins,* of counsel.

Before NICHOLS, *Judge*, Presiding, LARAMORE, *Senior Judge*, and KASHIWA, *Judge*.

"This case is before the court on defendant's motion for partial summary judgment. Plaintiff has opposed the motion on the grounds that there are material questions of fact in dispute and as a matter of law defendant is not entitled to summary judgment. After consideration of the briefs and the oral arguments, we deny defendant's motion for partial summary judgment on the ground that there are material facts in dispute.

"Plaintiff is an integrated miner-manufacturer of brick. It claimed depletion allowance on its mining activities for fiscal years 1956 through 1963. In so doing, plaintiff utilized the 'representative market or field price method' of ascertaining its constructive gross income for purposes of computing its depletion allowance in each of the taxable years in dispute. Treas. Reg. § 1.613–4(c) (1972).

"Defendant contends that plaintiff cannot use the 'representative market or field price method' in arriving at its constructive gross income from mining since all the representative market prices plaintiff has suggested ($9.90 per ton, $10.50 per ton, and $11.50 per ton) run afoul the presumption that they are not representative market prices, Treas. Reg. § 1.613–4(c)(6) (1972), and plaintiff has not alleged any facts to rebut this presumption. Therefore, defendant contends that plaintiff must ascertain its constructive gross income from its mining operation under the 'proportionate profits method.' Treas. Reg. § 1.613–4(d) (1972).

"Further, defendant argues that this taxpayer has twice before tried to use the representative market or field price method in figuring its depletion allowance and failed. *United States* v. *Henderson Clay Products*, 324 F. 2d 7 (5th Cir. 1963), *rev'g* 199 F. Supp. 304 (E.D. Tex. 1961); *Henderson Clay Products* v. *United States*, 377 F. 2d 349 (5th Cir. 1967), *aff'g* 252 F. Supp. 1013 (E.D. Tex. 1966). However, in the previous two cases Treas. Reg. § 1.613–4(c)(6) (1972) was not in issue for it had not been promulgated in final form.

"Even assuming Treas. Reg. § 1.613–4(c)(6) (1972) is valid and applicable to the taxable years in dispute,[1] we find this case is unripe for summary judgment. There is the question of what is the true representative market or field price. In the claims for refund, plaintiff contended $10.50 per ton for the taxable years 1956 and 1963 and $11.50 per ton for the taxable years 1957 through 1962. In support of its brief in opposition to the motion for summary judgment, plaintiff filed affidavits asserting $9.90 per ton as the correct representative market or field price. The plaintiff has also placed in dispute a question over the correct accounting method to be used in applying the limitation established by Treas. Reg. § 1.613–4(c)(6) (1972). Plaintiff maintains there should be an allocation of the indirect overhead expenses which are not clearly attributable to either the mining or manufacturing portion of its business. Defendant contends there should be an allocation of the indirect overhead administrative expenses, but not the indirect overhead expenses attributable to the sales of the manufactured brick. Therefore, IT IS ORDERED

"1. That defendant's motion for partial summary judgment be and hereby is denied on the grounds that there are material facts in dispute, and

"2. That the case should be set for trial and the trial judge should first, assuming the regulation is valid and retroactive, allow the parties to present evidence on the questions of what the representative market price for ball clay is, if there is one, and what accounting method is proper in applying Treas. Reg. § 1.613–4(c)(6) (1972). If it still appears that the taxpayer will run afoul of the regulation after the representative market price is established and the proper accounting method determined, the trial judge should allow the parties to present relevant evidence relating to the ball clay mining industry and integrated miner-manufacturers, like plaintiff, to demonstrate whether the regulation as written and applied is valid and legally retroactive. The trial judge should then make his findings of fact and conclusions of law as to the

[1] Plaintiff, in its brief opposing summary judgment, also placed in issue the validity of Treas. Reg. § 1.613–4(c)(6) (1972) and the legality of its retroactive application.

applicability of the regulation to this taxpayer, the regulation's validity, and the legality of its retroactive application."

No. 356-75.—JANUARY 27, 1978

Dura-Installation Service

Contracts; performance; incentive bonus for accelerated completion of work.—Plaintiff contracted to install aluminum skirtings on mobile homes used to provide temporary emergency shelter for families displaced by flooding caused by tropical storm Agnes in 1972. In the present action seeking to overturn denial by the General Services Administration Board of Contract Appeals of plaintiff's appeals, plaintiff's first claim involves denial of an $85 per-unit incentive bonus, provided by an amendment to the contract, for accelerated completion. The second claim is for costs and lost profits for 477 units allegedly contracted for but not ultimately ordered to be skirted. In a recommended opinion (reported in full at 24 CCF ¶ 81,807), Trial Judge Kenneth R. Harkins held that of the 3,523 units plaintiff is entitled to recover the incentive bonus on 2,429 units, and that plaintiff is not entitled to recover on its second claim. On January 27, 1978 the court, by order, adopted the recommended decision as the basis for its judgment in this case, concluding and ordering that plaintiff is entitled to recover on the portion of its claim allowed and that judgment be entered for plaintiff for $206,465 with the petition dismissed as to the remainder of plaintiff's claim.

No. 182-77.—JANUARY 6, 1978

John M. Slattery

Military pay; reassignment; stabilized tour; voluntariness of resignation; correction board procedures.—On January 6, 1978 the court entered the following order:

Robert M. White, attorney of record, for plaintiff.

Alan L. Ferber, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

NICHOLS, *Judge*, Presiding, COWEN, *Senior Judge*, and BENNETT, *Judge*.

"This military pay case comes before the court on cross-motions for summary judgment. Plaintiff is a former Air Force officer who has served his nation with honor. He retired from the service on August 1, 1974, but contends his resignation was wrongfully coerced.

"Plaintiff was serving at Andrews Air Force Base in Maryland on a so-called stabilized tour in 1974, when, on April 1, he was notified of his pending reassignment to Minot AFB in North Dakota. Plaintiff opposed the transfer, but his objections were not heeded. Ultimately, he was given 7 days to choose between accepting the reassignment and retiring from the service. He chose to retire, leaving the service on August 1, 1974. On September 23, 1974, he applied to the Air Force Correction Board, asking that his retirement be voided and that he be recalled to active duty. He claimed that the transfer order was invalid because it denied him the 'stabilized tour' status he claimed and because it was based upon prejudicial attitudes of two of his supervisors. On June 12, 1975, the Correction Board denied plaintiff relief, advising him that he had not established a showing of probable material error or injustice. He filed suit on April 6, 1977, asking that the court give him back pay to the date of his retirement, that the transfer order to Minot AFB be declared invalid, that he be recalled to active duty, or alternatively, that we require the Correction Board to give him a hearing and reconsider his case.

"Plaintiff moved first for summary judgment. His motion was grounded on the assertions that Air Force regulations prohibited his transfer during the period of his stabilized tour and that his retirement was involuntary. Defendant's cross-motion revealed that the regulation upon which plaintiff relied was not effective until long after the transfer order and plaintiff's retirement, which plaintiff now concedes. Plaintiff has not been able to show us any regulatory impediment to the transfer order, nor have we been able to find one. The general rule is that the military in its discretion may allocate its personnel as it

sees fit, and plaintiff has not met his burden of showing that his reassignment was impermissible.[1]

"In any case, plaintiff's entitlement to back pay depends upon a showing that his retirement was illegal and that he should have been retained upon active duty. But the transfer involved no stigma or monetary disadvantage, and plaintiff's opportunity to choose between accepting the transfer and retiring precludes any claim that the retirement was made under duress; the presence of an alternative to retirement made the retirement voluntary. *Murphy* v. *United States*, 209 Ct. Cl. 352, 363–64 (1976); *Christie* v. *United States*, 207 Ct. Cl. 333, 338, 518 F.2d 584, 587–88 (1975) (civilian employee's retirement held voluntary because she had an alternative, though unpleasant); *Pitt* v. *United States*, 190 Ct. Cl. 506, 516, 420 F.2d 1028, 1034 (1970) (threat of court-martial did not make resignation involuntary); *McGucken* v. *United States*, 187 Ct. Cl. 284, 289, 407 F.2d 1349, 1351, *cert. denied*, 396 U.S. 894 (1969) (resignation chosen over reassignment *held* not coerced). The Air Force did not suggest to plaintiff that he should retire. Plaintiff's retirement having been voluntary, no monetary claim is presented.

"Plaintiff seems to think his resort to the Correction Board strengthens his claim, since, in his view, the Correction Board did not apply proper procedures, may have considered improper evidence, and failed to uphold its duty to correct errors and injustices. The procedures of which he complains, such as the consideration of *ex parte* opinions, the failure to provide a hearing, and the absence of written records, are ones which may be nonjudicial in character, but correction boards are not courts and we have recently upheld these procedures. *Flute* v. *United States*, 210 Ct. Cl. 34, 41, 535 F.2d 624, 628 (1976). This is not to say that those are the best procedures, and we are pleased to take notice that on May 13, 1977, they were changed by amendment of AFR–31–3. However, plaintiff's claim that

[1] Under a regulation effective at the time of his transfer orders, reassignment was permitted 'to serve in the best interests of the Air Force.' AFR 36–20, Table 9–8 (1973). An uncontroverted affidavit offered by defendant indicates that, under that standard, the transfer order was valid. It was also in accord with the recommendations in plaintiff's OERs. We cannot find anything arbitrary or in bad faith behind the transfer order which might vitiate it for an abuse of discretion.

changes in correction board regulations adopted in 1977 should be applied retroactively is without merit. Simply, until the board changed its procedural regulations, it was not obligated to refuse *ex parte* opinions, to explain reasons for denying hearings, or to maintain records indicating the bases for its decisions. As for the alleged failure of the board to adhere to its duty to correct injustices as well as errors, we need not here consider the jurisdictional arguments concerning our power to review correction board decisions or to remand to the board, because we cannot conclude any injustice was done. Plaintiff voluntarily chose to retire rather than accept a lawful transfer, and it was not unjust or illegal for the Air Force to accept his unqualified application for voluntary retirement. Plaintiff has no valid claim for money damages and does not state a claim within the jurisdiction of the court.

"Therefore, upon the briefs and oral arguments of the parties,

"IT IS ORDERED that defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied, and the petition is dismissed."

On March 3, 1978 the court denied plaintiff's motion for rehearing.

NOS. 468–73 AND 469–73.—JANUARY 27, 1978

Packer Industries, Inc.

Renegotiation of contracts; counterclaim; judgment in aid of execution of order.—On January 27, 1978 the court entered the following order:

*

Lawrence S. Smith, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG, and BENNETT, *Judges.*

* On September 9, 1977, the trial judge allowed a motion to withdraw by plaintiff's original counsel and directed plaintiff to designate new counsel within 30 days. That time has now expired, as has one 30 day extension, without corporate plaintiff's acting formally to appoint counsel.

"These actions, initially filed by plaintiff seeking review pursuant to 50 U.S.C. App. § 1218 (Supp. V, 1975) of two 'Determinations of Excessive Profits' by the Renegotiation Board, are now before the court on defendant's uncontested Motion for Judgment in Aid of Execution of the Renegotiation Board orders of September 19, 1973. These orders concerned the fiscal year ending June 30, 1968, and were issued for two now defunct companies, to which plaintiff became successor in interest by a corporate merger on July 1, 1968. The profits which were determined to be excessive totaled $125,000.00 in case number 468–73 and $150,000.00 in case number 469–73. After deductions were made for various state and federal tax credits these sums were reduced to $60,801.37 and $64,378.48, respectively.

"Although plaintiff initiated the action in this court, it neither paid the amount in question to the Government nor posted bond as required by Rule 26. Defendant, noting these facts, has counterclaimed for the entire amount[1] pursuant to 28 U.S.C. § 1503, § 2508 (1970) and 50 U.S.C. App. § 1215(b)(3)(1970). Because we believe plaintiff's failure to comply with proper procedures to be without justification, we grant defendant's motion.

"Plaintiff sought to excuse its failure to comply with these statutory requirements by alleging that it had consistently sustained net losses, that it was employing all of its capital in an attempt to 'sustain a financially competent enterprise,' and that any 'attempt to post a bond in the amount generally called for in Rule 26 will be detrimental to the financial efficacy of the plaintiff and may well severely thwart its ability to exercise its statutory right to litigate its claim in this case. *See Sandnes' Sons, Inc.* v. *United States,* 199 Ct.Cl. 107, 462 F.2d 1388 (1972).'

"These allegations were contained in an answer filed on March 18, 1974. On July 15, 1977, more than three years later, the defendant filed its Motion for Judgment in Aid of Execution which is currently before us. During this extended period of time, plaintiff has done nothing to prosecute its claim and has still neither paid the assessments nor posted bond. Plaintiff has, however, in the

[1] Defendant's counterclaims totalled $275,000, plus any additional excessive profits as determined by this court, plus interest as provided by law.

interim, 'sold (*i.e.*, contracted to sell) its property, assets and business for $1,150,000.' Defendant has submitted exhibits indicating that plaintiff is no longer in business and that plaintiff received, in December 1976, 'a bank check for $610,000, a promissory note for $200,000, and an additional bank check of $340,002 (less the aggregate sum of accounts payable and accrued liabilities, but plus the sum of any prepaid expenses). Defendant asserts that this clear availability of liquid assets, sufficient either to pay the assessment or post bond, renders the *Sandnes' Sons* pre-judgment hearing doctrine inapplicable in the present case. We agree.

"Although *Sandnes' Sons, supra,* remains a strong statement of this court's unwillingness to grant a judgment in aid of execution where such a judgment may deny due process by threatening such harm to a contractor that he would be effectively 'chilled' in his pursuit of a fair redetermination, we are not now faced with such a situation. The removal of cash from the pocket of the complaining contractor,[2] when such cash is as available as it has been demonstrated to be in the case at hand, does not represent injury sufficient to 'chill' the contractor's further appeal to this court. Indeed, it was just such a detriment to the contractor which Congress envisioned to be necessary to prevent frivolous redetermination suits and to protect the pecuniary interests of the Government while such redetermination was underway. *See, e.g., Manufacturers Service Company, Inc.* v. *United States,* 207 Ct.Cl. 185, 193, 518 F.2d 1202, 1206 (1975).

"In any event, from the uncontradicted facts now before us, it appears that plaintiff initiated these suits, was subject to a compulsory, *see Solitron Devices, Inc.* v. *United States,* 210 Ct.Cl. 352, 357, 537 F.2d 417, 420 (1976) counterclaim by defendant, and thereafter acquired cash sufficient to satisfy either the excessive profits assessment or the Rule 26 bond. Plaintiff's obvious failure to comply with Rule 26, along with the defendant's three-year delay

[2] Plaintiff's receipt of at least $610,000 would have put in its pocket sufficient cash to pay the $60,801.37 assessed by the Government in 468–73, plus the $64,378.48 assessed in 469–73, or to post the 100% bond required by Rule 26 if it desired seriously to pursue its redetermination claim.

in seeking this judgment—which would indicate that defendant is making no affirmative attempt to "chill" plaintiff's efforts—renders judgment in aid of execution appropriate in this case.

"IT IS HEREBY ORDERED, upon consideration of the petitions and answers, defendant's unopposed motion, and the exhibits submitted therewith, without oral argument, that defendant's motion is granted, and judgment in aid of execution is entered for defendant in the amount of $60,801.37 in case number 468–73 and $64,378.48 in case number 469–73, with each of these amounts to be increased by interest as allowed by law. 50 U.S.C. App. § 1215 (b)(2)(Supp. V, 1975)."

No. 415–74.—JANUARY 27, 1978

Lee Roy E. Ardell

Military pay; correction of military records; relief granted administratively; final settlement; Court of Claims jurisdiction; lack of money claim.—On January 27, 1978 the court entered the following order:

Clifford A. Dougherty, attorney of record, for plaintiff. *J. B. Martin,* of counsel.

Alan L. Ferber, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"This case, before the court on defendant's motion to dismiss for lack of jurisdiction, presents the situation of a serviceman dismissed from the Army upon his conviction for charges which the United States Court of Military Appeals ultimately found unsubstantiated. Plaintiff, having won a reversal of his conviction, sued here for pay lost by reason of his separation from the service and for correction of his military record to expunge all references to his court-martial conviction. Proceedings here were suspended while plaintiff pursued administrative remedies within the Army.

"The Army Board for Correction of Military Records recommended granting relief to plaintiff for the injustice done to him. The Secretary of the Army, through his delegate, ordered the correction of plaintiff's records to show that he served in an inactive status during the period when his case was under appellate review, that he was recalled to active duty once the charges against him were dismissed, and that he was voluntarily retired for longevity after 20 years of active duty. Plaintiff was offered, and he accepted $75,392.74 as a settlement of money claims resulting from correction of his record. This was active duty pay and allowances, less a setoff. Therefore, plaintiff has no present money claim against the United States, since 10 U.S.C. § 1552(c)(1970) provides in relevant part, 'A claimant's acceptance of a settlement under this section fully satisfies the claim concerned.'

"Plaintiff no longer contends he has a money claim against the United States, but he complains of the Army's failure to grant all the relief he requested. Specifically, the Army has not granted his request to expunge from his records all references to his court-martial conviction. It is clear from the record that the Army has granted all the relief recommended by the correction board. Plaintiff insists our precedents require that correction boards not give less than full relief, citing, among others, *Denton* v. *United States*, 204 Ct. Cl. 188, 195 (1974), *cert. denied*, 421 U.S. 963 (1975). The proposition plaintiff states is good law, where applicable, but the principle cited does not apply here where plaintiff has no money claim remaining at the time of judgment. This court's remand statute, Pub. L. 92–415 (amending 28 U.S.C. § 1491), 86 Stat. 652 (1972), permits this court to order the correction of records only "as an incident of and collateral to any * * * judgment." But there can be no judgment to which equitable relief such as plaintiff seeks can append unless there is a present money claim against the United States. Such a claim is the *sine qua non* of this court's jurisdiction. *United States* v. *Testan*, 424 U.S. 392 (1976); *United States* v. *King*, 395 U.S. 1 (1969); *Austin* v. *United States*, 206 Ct. Cl. 719, *cert. denied*, 423 U.S. 911 (1975). Lacking jurisdiction, this court must grant defendant's motion to dismiss.

"IT IS THEREFORE ORDERED, upon the written submissions of the parties, but without oral argument, that defendant's motion to dismiss is granted and plaintiff's petition is dismissed."

No. 285–76. JANUARY 27, 1978

Shawn D. Clark and Tricia D. Clark, Minors, by Patricia I. Clark, their legal guardian

Civilian pay; Civil Service Retirement Act; survivor annuities; illegitimate children; constitutionality of live-with requirement.—On January 27, 1978 the court entered the following order:

Edward L. Merrigan, for plaintiffs.

Donnie Hoover, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG, and BENNETT, *Judges.*

"This is a suit, brought on behalf of Shawn D. Clark and Tricia D. Clark (minor children, plaintiffs), for recovery of death benefits and survivor annuities allegedly due them pursuant to the Civil Service Retirement Act of 1930, as amended. 5 U.S.C. §§ 8331–48 (1970). Upon the death of their father, George G. Isaacson, an employee of the Veteran's Administration, the children made timely application to the Civil Service Commission, Bureau of Retirement, Insurance and Occupational Health (BRIOH) for payment of benefits under 5 U.S.C. § 8341(e). BRIOH denied their claim pointing to statutory language which required illegitimate children to have lived with their father in a 'regular parent-child relationship' in order to qualify for survivor annuities.[1] After the Civil Service

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[1] 5 U.S.C. § 8341 provides, in pertinent part, as follows:

§ 8341. *Survivor annuities.*

(a) For the purpose of this section—

(3) 'child' means—

(A) * * * (ii) a stepchild or recognized natural child who lived with the employee or Member in a regular parent-child relationship;

Commission (CSC) Appeals Board affirmed the BRIOH determination,[2] the plaintiffs filed suit in this court. The matter is now before us on plaintiffs' motion for summary judgment.[3]

"Subsequent to the filing of the instant case, this court has had occasion to deal with the precise statutory provisions now before us. In *Gentry* v. *United States*, 212 Ct.Cl. 1, 546 F.2d 343 (1976),[4] we held a portion of 5 U.S.C. § 8341 to be unconstitutional insofar as it discriminates between legitimate and illegitimate children solely on the basis of their status at birth. Since the Government now quite properly concedes that *Gentry, supra,* is dispositive of the case now before us, the only issue to decide is whether we should remand to the CSC as we did in *Gentry.*

"Despite the Government's request that we remand to the CSC for further factual determination, it is not appropriate to do so in this case. In *Gentry,* it was necessary to determine 'whether plaintiff is in fact the child of the deceased annuitant, and whether the latter recognized and supported him as such.' 212 Ct. Cl. at 23, 546 F.2d at 355. Here, on the other hand, there is no dispute over the facts of parentage, recognition, and support. Indeed, a prior, valid, judgment is conclusive on these points. *Clark* v. *Isaacson,* No. 5625 (Dist.Ct., 1st Dist. of Mont., Broadwater County, June 2, 1972). As there are thus no factual determinations to be made bearing on the right to recover, a remand to the CSC would serve no purpose.

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[2] The CSC held that there was no 'regular parent-child relationship' at the time of the father's death notwithstanding the following facts: George Isaacson was the father of both children, he had in fact lived with them and their mother under the same roof for some six years, he had thereafter been subject to a court decree to pay child support, and he had continued to provide child support until the time of his death.

[3] This court is aware of defendant's assertion that, after finding the children not eligible, CSC made an award of $7,755.12 to the father of George G. Isaacson. In 1976, defendant filed a contingent third party cross-motion against the father, but defendant has not followed up on its third party cross-motion, and it is not before the court on this motion for summary judgment.

[4] The case is also reported at 212 Ct.Cl. 27, 551 F.2d 852 (1977) (Order denying Defendant's Motion for Rehearing). Defendant, perhaps because of the compelling factual circumstances present in the case now before us (*see* note 2, *supra*), has apparently abandoned its contention (which it made on motion for rehearing in *Gentry*) that some determination as to 'degree of dependency' might be necessary.

"In summary, on the uncontested facts of parentage, recognition, and support, plaintiffs have shown that they have a right to recover the benefits provided by 5 U.S.C. § 8341(e). Because this court has previously held a portion of 5 U.S.C. § 8341 to be unconstitutional insofar as it discriminates between legitimate and illegitimate children solely on the basis of their status at birth, and since there are no factual issues which require CSC determination, we hold that plaintiffs are entitled to recover the annuity provided by the statute.

"Accordingly, IT IS HEREBY ORDERED, upon consideration of the pleadings and exhibits, without oral argument, that plaintiffs' motion for summary judgment is granted. Judgment is therefore entered for plaintiffs, and the cause is remanded to the Trial Division for further proceedings under Rule 131(c) to determine the amount to be awarded plaintiffs, consistent with this opinion."

No. 478–76. JANUARY 27, 1978

Mark D. Diggs

Military pay; disability retired pay; resignation; correction board proceedings; VA schedule for rating disabilities; burden of proof; presumption of correctness.—On January 27, 1978 the court entered the following order:

Richard S. Smith, attorney of record, for plaintiff.

LeRoy Southmayd, Jr., with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant. *Levator Norsworthy, Jr.*, of counsel.

Before DAVIS, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

"Defendant has moved for summary judgment in opposition to plaintiff's claim for medical retirement (in lieu of resignation from military service), for back pay, and for attorney fees.

"Plaintiff, an Army officer, received combat injuries during service in Vietnam in 1971. Upon return to the United States at the conclusion of that tour of duty he was examined on May 15, 1972, by an Army medical board

which found him to be "not qualified for retention in military service." An informal Physical Evaluation Board (PEB) then considered his case on July 3, 1972, and agreed that he should not be retained and recommended that he be permanently retired from active service with a combined disability rating of 40 percent. Plaintiff concurred in the findings and recommendations.

"In accordance with Army regulations, the PEB decision was reviewed by the Army Physical Review Council (APRC) which on July 21, 1972, disagreed with the PEB and found that plaintiff was physically fit for active duty, that his injuries had required neither hospitalization nor intensive treatment and had not significantly interfered with his active service, and that the injuries were neither ratable at more than 10 percent nor incapacitating.

"Thereafter, plaintiff was accorded a formal PEB hearing on August 25, 1972. The PEB upon review recommended that plaintiff be permanently retired by reason of physical disability with a rating of 40 percent. Plaintiff concurred.

"The formal PEB findings and recommendations were again considered and reviewed by the APRC which, on September 19, 1972, reiterated its previous determination that plaintiff was fit for performance of active military duty or for administrative separation.

"Plaintiff challenged the APRC again and his case went to the Army Physical Disability Appeal Board (APDAB) for review. On October 16, 1972, the APDAB agreed with the ARPC.

"The Surgeon General thereafter assigned plaintiff a physical profile and, on October 30, 1972, advised the Adjutant General thereof. It was also suggested that plaintiff should report for medical treatment when suffering from headaches, should have non-command positions until his medical condition was resolved, and should not be exposed to loud noises. The profile determined that plaintiff was unable to perform full effort except for moderate periods, that he had a slightly limited mobility of joints and muscular weakness but that the defects did not prevent moderate marching, climbing, running, digging, or

prolonged effort, and that his hearing level was not below retention standards.

"On April 11, 1973, plaintiff tendered his 'unqualified resignation' from the Army, under AR 635–120, to become effective May 7, 1973, and further stated:

> 'I desire to tender my resignation because I no longer desire to make the United States Army my career. I desire to accept employment with a legally established law enforcement agency as indicated at Inclosure 1. * * *'

" 'Inclosure 1' stated that plaintiff had accepted employment with the State of Arkansas.

"Plaintiff's resignation was approved, effective May 7, 1973, and he received an honorable discharge. He was then appointed a first lieutenant in the United States Army Reserve. He applied for Veterans Administration disability benefits and was rated by the VA at 40 percent disabled, effective May 8, 1973.

"In an application to the Army Board for the Correction of Military Records (ABCMR) dated January 2, 1975, plaintiff sought to change the characterization of his resignation to that of retirement for physical disability. The ABCMR requested and received an advisory Medical Evaluation Opinion from the Army concerning plaintiff. This opinion recognized that plaintiff might possess conditions ratable by the VA Schedule for Rating Disabilities, should he be found physically unfit, but stated that the 'non-medical evidence in particular suggests that the decreased work performance noted was caused largely by factors other than applicant's physical condition.' On November 26, 1975, plaintiff was notified by the ABCMR that his application was denied. The non-medical evidence referred to pertains to certain personal problems plaintiff had with his housing and family illness, factors which an OER in 1972 revealed as the cause of his dissatisfaction with the Army and his efforts to secure a disability retirement. There is no reason to doubt, however, that plaintiff did suffer from headaches and other disabilities but there is no reason to doubt the findings that his illness was not such as to require extensive treatment, hospitalization, or disability retirement, notwithstanding the contra-

dictory reports referred to above on the degree of his disability.

"Plaintiff has not responded to defendant's motion for summary judgment. Notwithstanding his failure to respond we have carefully examined all the records submitted for our attention and find that they are substantial evidence for the ultimate determination reached through the multiple Army medical reviews and by the Correction Board in plaintiff's case. Plaintiff has the burden of proof. He has not met this burden and has not overcome the presumption which attaches to the correctness of administrative actions. Under the relevant statute (10 U.S.C. §§ 1201–1221), regulations, and authorities, the Secretary has the power to determine fitness for military duty. The court has no jurisdiction to upset his actions absent a violation of law or regulation, or a showing that substantial evidence was lacking to support those actions, and absent any cogent, convincing proof whatever of arbitrary, capricious action on his part. "* * * [J]udges are not given the task of running the Army." *Orloff* v. *Willoughby,* 345 U.S. 83, 93 (1953); *Wesolowski* v. *United States,* 174 Ct. Cl. 682 (1966). Further, the fact that plaintiff has obtained a compensable disability rating from the Veterans Administration is alone no basis for military disability retirement which is based upon other grounds and upon other statutes and regulations. AR 635–40, para. 4–25 (1970); *Finn* v. *United States,* 212 Ct. Cl. 353, 548 F.2d 340 (1977); *Storey* v. *United States,* 209 Ct. Cl. 174, 531 F.2d 985 (1976); *Wood* v. *United States,* 176 Ct. Cl. 737 (1966); *Johnson* v. *United States,* 138 Ct. Cl. 81, 85, 149 F.Supp. 648, *cert. denied,* 355 U.S. 850 (1957); *Wales* v. *United States,* 132 Ct. Cl. 765, 769, 130 F.Supp. 900, 903 (1955).

"For the foregoing reasons we find it unnecessary to address other defenses raised by the motion.

"IT IS THEREFORE ORDERED, upon consideration of the pleadings and motion, without oral argument, that defendant's motion for summary judgment is granted. The petition is dismissed."

No. 154-77. JANUARY 27, 1978

Lloyd Taylor

Tax; claim for refund; limitations on filing of claim.—On January 27, 1978 the court entered the following order:

Lloyd Taylor, pro se.

Patricia B. Tucker, with whom was *Assistant Attorney General M. Carr Ferguson,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"Lloyd Taylor, an attorney with accounting experience, sues here for refund of some $2,557 in taxes paid under the Federal Insurance Contributions Act (§§ 3101 *et seq.* of the Internal Revenue Code of 1954), plus interest, for 1965 through 1973. His claim is that he 'is a minister in the Libertarian Religious Order' and that 'it is contrary to plaintiff's religion to contribute to a mandatory government pension plan.' The defendant has moved for summary judgment on the grounds (among others) that (a) taxpayer failed to file timely refund claims for 1965 through 1970, and (b) as to 1971–1973, limitations has expired since more than two years have elapsed in each instance after the refund claims for those years were rejected.

"We grant the Government's motion to which plaintiff has not responded. A timely refund claim to the Internal Revenue Service is a necessary prerequisite to a refund suit. Int. Rev. Code, § 7422(a). The Service has been unable to locate any refund claim for 1965–1970 or any indication that any such claims were filed, and taxpayer has been unable to produce any copies of such claims or any proof whatever that he filed any timely claims for that period. The petition must therefore be dismissed as to those years. *Bondanza v. United States,* 207 Ct. Cl. 945 (1975).

"Taxpayer did file timely refund claims for 1971–1973, but the Service disallowed all of those claims by March 11, 1975. Suit was not brought here until March 21, 1977. This is beyond the two-year period allowed by § 6532(a)(1) of the Internal Revenue Code, and accordingly the court lacks jurisdiction of the claims for 1971–1973. *Loew's Theatres, Inc. v. United States,* 207 Ct. Cl. 943 (1975).

"IT IS THEREFORE ORDERED AND CONCLUDED, without oral argument, that defendant's motion for summary judgment is granted and the petition is dismissed."

No. 158–77. JANUARY 27, 1978

Peter J. Vlahakis

Court of Claims jurisdiction; tort claim; constitutional claims outside court's jurisdiction; tax claim; statutes of limitations.—On January 27, 1978 the court entered the following order:

Peter J. Vlahakis, pro se.

Lynn J. Bush, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"This *pro se* case is before the court, without oral argument, on the defendant's motion to dismiss. The plaintiff alleges that he has suffered financial loss in connection with various real estate and financial transactions as a result of the conspiracies of executive and judicial officials of the State of Illinois, that he was falsely imprisoned in the Cook County jail, and that his wife was temporarily paralyzed from the shock of his imprisonment. He seeks damages from the defendant because the federal courts have negligently failed to protect his 4th, 5th, and 14th amendment rights under the Constitution. He also alleges harassment of both his wife and himself by Internal Revenue Service agents, which caused injury to his reputation, business connections, credit, and professional career. In addition, he claims that he is entitled to a tax refund for the year 1963; his claim therefor had been disallowed by the IRS in a notice dated December 16, 1965.

"The plaintiff's assertions concerning Illinois state officials and courts are obviously beyond this court's jurisdiction. The allegations in regard to harassment by I.R.S. agents clearly sound in tort and this court has no jurisdiction under 28 U.S.C. § 1491 (1970) over claims sounding in tort. *Vincin v. United States,* 199 Ct. Cl. 762,

765, 468 F.2d 930, 932 (1972); *Clark v. United States*, 198 Ct. Cl. 593, 597, 461 F.2d 781, 783, *cert. denied*, 409 U.S. 1028 (1972); *Algonac Mfg. Co. v. United States*, 192 Ct. Cl. 649, 663, 428 F.2d 1241, 1249 (1970). In view of the nature of the claims and of plaintiff's prior litigations, it would not be in the interest of justice to transfer this part of the case to the district court for consideration under the Tort Claims Act.

"The claims under the amendments to the Constitution are claims under constitutional provisions which do not in themselves grant a right to payment of money and are therefore beyond the limits of this court's jurisdiction. *United States v. Testan*, 424 U.S. 392, 401–02 (1976); *Eastport Steamship Corp. v. United States*, 178 Ct. Cl. 599, 605, 372 F.2d 1002, 1007 (1967).

"Lastly, the plaintiff's claim for an income tax refund, denied by the Internal Revenue Service in 1965, is now barred by the statute of limitations under I.R.S. § 6532(a).

"IT IS THEREFORE ORDERED AND CONCLUDED that the defendant's motion to dismiss is granted and that the plaintiff's petition will be dismissed if a motion for leave to file an amended petition is not filed within 30 days.[1]"

On May 1, 1978 plaintiff filed an amended petition; on June 9, 1978 defendant filed opposition to plaintiff's amended petition.

No. 188–77. JANUARY 27, 1978

Archer N. Martin II

Military pay; promotion; mandatory discharge by non-selection; "constructive time".—On January 27, 1978 the court entered the following order:

Archer N. Martin, pro se.

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[1] In his answer to the defendant's motion to dismiss, plaintiff states that he intends to amend his petition to cover amounts owed him as tax refunds for the years 1964 through 1968. The defendant urges that such claims would be time-barred. However, without further facts, it cannot be decided that the plaintiff's claims for those years would be time-barred. See *Detroit Trust Co. v. United States*, 131 Ct. Cl. 223, 130 F. Supp. 815 (1955). Therefore, the plaintiff may seek leave of the court to amend his petition in accordance with Rule 39 upon an adequate showing that he has made proper claims for refunds in respect to those years and that his request for leave to amend his petition is timely under I.R.C. § 6532(a).

Allen L. Ferber, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, *Judge*, Presiding, KUNZIG, and BENNETT, *Judges*.

"This *pro se* action for proposed lost retirement income and damages resulting from plaintiff's mandatory discharge from the United States Air Force Reserves prior to reaching the 18 years 'retirement sanctuary' is before the court on defendant's unopposed motion for summary judgment. Because plaintiff fails to state a claim upon which this court can grant relief, we hold for defendant.

"Martin (plaintiff) entered the Air Force Reserves March 17, 1957, but because of certain civilian experience, he received, *at his own request*, 'constructive time' under then-existing regulations so that his affiliation date for 'total years of service' purposes was June 15, 1951, and his promotion service date was June 15, 1954. The effect of this 'constructive time' was to increase plaintiff's longevity, which resulted in greater pay and an accelerated promotion schedule. This accelerated promotion schedule, in turn, resulted in plaintiff's being considered—and passed over—twice for promotion to the rank of Lieutenant Colonel prior to his reaching the 'retirement sanctuary' of 18 years of service. Twice failing to be selected for promotion, plaintiff resigned his commission (rather than face mandatory discharge or retirement without pay) and thus did not become entitled to certain retirement benefits to which he would have otherwise been entitled upon completing twenty years of service and reaching 60 years of age.

"Plaintiff now contends that under regulations currently in force, he would not have received his 'constructive time' and would have been within the 'retirement sanctuary' prior to being twice passed over.

"He further asserts that his non-selection resulted, at least partially, from the Air Force's use of abbreviated evaluation forms, on which substantial or lengthy comments were allegedly discouraged, to record his performance during the years prior to his eligibility for selection,

and that the consequent failure to evaluate fully his performance breached his contract of employment by which the Air Force 'agreed to recognize [his] efforts through promotion and compensation based on uniformly applied standards . . . .'

"He finally argues that his mandatory 'honorable discharge' forced him to join the Air National Guard at a 'considerably reduced status' in order to meet minimum time requirements for retirement, has caused him to suffer 'great mental anguish, pain and suffering in the amount of $50,000.00,' and will cause him to 'suffer the loss of approximately $10,000.00 in retirement pay over the period of his projected life expectancy of approximately 15 years.'

"Defendant responds that plaintiff's only real complaint is that he was not selected for promotion to Lieutenant Colonel. The Government reasons that the Air Force at all times acted within the controlling regulations; that plaintiff does not allege any breach of regulation; that plaintiff's claim for anguish, pain and suffering is a claim sounding in tort not cognizable by this court; and that, in any event, this court has repeatedly held that it is 'not in the military promotion business' (citing *Brenner* v. *United States*, 202 Ct.Cl. 678 (1973), *cert. denied* 419 U.S. 831 (1974). We agree with the Government.

"Plaintiff's first difficulty is that his somewhat confused allegations in no way demonstrate that any regulation was violated or that any rule of the Air Force was improper. His claim is based on the alleged unfairness of the regulations, which he admits the Air Force followed, as they applied to him. We note that he did not object when they were applied to accord him higher pay and advanced promotions. We also note that he makes no allegation that all other Air Force members similarly situated did not receive exactly the same treatment under the same regulations. In short, he makes not even an allegation that the Air Force acted in an arbitrary or capricious manner or that its actions violated statutes or regulations. Plaintiff alleges nothing which provides a basis for this court to change its longstanding principle that we 'are not in the

military "promotion business." ' *See, e.g., Brenner, supra* at 693.

"Plaintiff's purported contractual claim suffers similar shortcomings. He shows nothing which indicates any impropriety or unfairness in the use of the abbreviated forms; he cites neither statute nor case law to support his vague contractual assertions; and he has made no allegation or showing that the Air Force standards of performance and evaluation were applied any differently to him than they would have been to any other officer in his position. Indeed, plaintiff's allegations make it clear that the Air Force meticulously followed its own regulations. Again, plaintiff's only real complaint appears to be that the operation of these regulations resulted in his non-selection for promotion.

"Plaintiff's alleged right to $50,000 compensation for 'mental anguish, pain and suffering' sounds in tort (even though plaintiff has alleged no tortious action by the Air Force) and is, therefore, not within our jurisdiction, *see, e.g., Algonac Mfg. Co.* v. *United States*, 192 Ct.Cl. 639, 663, 428 F.2d 1241, 1249 (1970).

"Plaintiff's alleged money damages of $10,000 for lost retirement pay are highly speculative and would become due only *if* he were entitled to promotion and *if* he reached age 60. Under no circumstances can money be due at the present time; therefore, this portion of plaintiff's claim is also without remedy in this court. *United States* v. *Testan*, 424 U.S. 392 (1976).

"It is evident, in summary, that even interpreting the pleadings and exhibits in the light most favorable to plaintiff, as we must, the plaintiff has not demonstrated any actions by the Air Force which would entitle him to a current money judgment against the Government, and that plaintiff has, therefore, failed to state a claim upon which relief can be granted.

"IT IS HEREBY ORDERED, upon consideration of the pleadings and exhibits, without oral argument, that defendant's unopposed motion for summary judgment is granted and plaintiff's petition is dismissed."

Plaintiff's motion for rehearing was denied March 3, 1978.

Twilla Darlene Hoar, Independent Executrix, etc., No. 330–77

January 27, 1978

Henry Monroe Slagle, Administrator, etc., No. 331–77

Court of Claims jurisdiction; pendency of suit in another court; tort claim; implied-in-fact contract; employees of independent Government contractor.—On January 27, 1978 the court entered the following order:

Morris Lavine, attorney of record, for plaintiffs. *Joan Celia Lavine* and *James T. Rudd,* of counsel.

Robert E. O'Neill, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"These identical cases come before the court, without oral argument, on defendant's motions to dismiss plaintiffs' claims because of lack of jurisdiction of the subject-matter. The petitions assert that decedents, third party creditors and beneficiaries of a contract between the United States and various contractors and subcontractors, while themselves under contract to perform special services for the United States, died aboard an Air Force aircraft which crashed over the high seas on June 13, 1971. A class action on behalf of all heirs of the victims of this crash, who had not been represented by a personal representative, was certified in the District Court for the Central District of California shortly before the statute of limitations would have run. Thereafter, the class was decertified with the members being given the opportunity to file motions for leave to intervene in actions pending prior to the decertification order's effective date. On August 23, 1976, both plaintiffs' motions to intervene in consolidated cases before the District Court for the Central District of California were granted. A motion by the United States to dismiss

each complaint was then submitted, early in 1977, to that District Court; one ground for this motion was the lack of jurisdiction of the District Court. Plaintiffs then instituted these actions in the Court of Claims on June 10, 1977. On September 1, 1977, the District Court issued its order dismissing plaintiffs' suits there against the United States on the ground that the action could be maintained in the District Court only under the Suits in Admiralty Act, 46 U.S.C. §§ 741–52, and that the jurisdictional bar of that Act had already fallen. *Hoar, et al. v. Ling-Temco-Vought, Inc.*, Civil No. 72–1294–ALS, S.D. Calif.

"In this court, plaintiffs assert, on information and belief, that decedents and the government 'agreed' that the aircraft was airworthy prior to its boarding by decedents. The crash and decedents' consequent loss of life are said to constitute a material breach of the contract to provide an airworthy and safe airplane, for which damages of $3,000,000 are sought. Defendant's current motions to dismiss assert that this court lacks subject-matter jurisdiction over these claims for two reasons: (1) the pending suit against the United States in the other court on the same claim precludes this court's jurisdiction under 28 U.S.C. § 1500 (1970); and (2) in any event, these claims sound in tort and are thus beyond our jurisdiction under 28 U.S.C. § 1491 (1970). Plaintiffs originally requested that we deny the government's motions to dismiss and defer further action on their claims before this court, pending a decision by the District Court. Such a stay of proceedings was necessary, it was alleged, to avoid the predicament that could be caused by the dismissal of their suits in the District Court for jurisdictional reasons after the statute of limitations had run, thereby precluding the refiling of their suits in this court; in these circumstances, it was said, dismissal of plaintiffs' claims in this court would bar them from having their claim heard in any court.

"However, now that the District Court cases against the United States have been dismissed for lack of jurisdiction, the bar of 28 U.S.C. § 1500 is no longer applicable, and that ground of defendant's motion to dismiss must be denied. *Brown v. United States*, 175 Ct. Cl. 343, 348–49, 358 F.2d 1002, 1004–05 (1966).

"The question remains whether suit in this court may be sustained on a contract theory or whether each action here is barred as one which 'smacks more of tort than of non-tortious obligation.' *Eastport S.S. Corp. v. United States*, 178 Ct. Cl. 599, 609, 372 F.2d 1002, 1010 (1967). As a result of discovery undertaken by plaintiffs it is now clear that no contract of employment existed between either decedent and the United States at any relevant time. Both decedents were aboard the crashed aircraft in the capacity of employees of independent contractors of the United States. The Government has expressly so represented in response to plaintiffs' motions for discovery of any contracts between the decedents and the United States, and plaintiffs have given us no reason whatever to question the defendant's formal representation to the court.[1]

"Nor is there any basis in the circumstances for finding an implied-in-fact contract between decedents and the Federal Government. As employees of independent contractors with the Government decedents would not normally have any contractual relationship with the United States—any more than would the employees of the thousands of other independent contractors with the Federal Government—and plaintiffs have presented nothing to suggest otherwise. That decedents perished while flying on an Air Force plane could conceivably suggest some tortious liability on the part of the Government but it would not in itself predicate an implied-in-fact contract. See *Bigby* v. *United States*, 188 U.S. 400 (1902) (denying contractual theory of recovery for injuries resulting from the Government's ownership and operation of an elevator in a public building). Accordingly, the only possible claim would be tortious in nature, and since Congress has withheld from this court original jurisdiction over tort suits against the Government (*Eastport S.S., supra;* 28 U.S.C. § 1346(b)), we would lack subject matter jurisdiction of such a tort claim.

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[1] For this reason we deem plaintiffs' motions of November 21, 1977 to compel discovery of contracts to have been complied with by the defendant, and deny any further order on those motions.

"IT IS THEREFORE ORDERED AND CONCLUDED that defendant's motions[2] are granted and the petitions are dismissed."

Plaintiffs' motion for rehearing and to set aside order was denied April 4, 1978.

No. 334–77. JANUARY 27, 1978

Edward Davis, Administrator,
etc., et al.

Eminent domain; rights of claimants not appearing in condemnation action; service of notice; res judicata and/or collateral estoppel.—On January 27, 1978 the court entered the following order:

Samuel A. Culotta, attorney of record, for plaintiffs. *Frank W. Marsalek,* of counsel.

David Waters, with whom was *Assistant Attorney General James W. Moorman,* for defendant.

Before DAVIS, *Judge,* Presiding; KUNZIG and BENNETT, *Judges.*

"This is an inverse condemnation case in which the plaintiffs (administrators and trustees) claim that the estates and persons they represent (which we shall call the Foller and Rohleder interests) were in fact the only owners of a piece of property (in the District of Columbia) condemned by the Federal Government, but through the Government's wrong failed to receive the full award made by the District Court for the District of Columbia; instead, half of the award was given and paid, allegedly wrongfully, to two other claimants. Plaintiffs say that these claimants (charities) were not entitled to any of the award but that all of it should have gone to plaintiffs on behalf of the Foller and Rohleder interests.

"Since the case must be litigated further and all we have now before us is the petition (plus exhibits) and the defendant's motion to dismiss, it is both unnecessary and

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[2] Since we have considered matters outside the pleadings, we treat defendant's motions to dismiss as motions for summary judgment. Rule 38(b).

inappropriate to set out the presumed facts in any detail. Suffice it to say that, pursuant to Fed. R. Civ. P. 71A(d)(3)(ii), the Government, which purported not to have the identities and addresses of the Foller and Rohleder interests made general service by publication on 'Unknown Owners', as well as specific service on the two charities. The charities appeared and claimed half of the award (which they received), but neither the plaintiffs nor the Foller or Rohleder interests appeared. However, about two years after the final condemnation judgment, plaintiffs twice moved the District Court (in the condemnation suit) to set aside the prior distribution order and to direct the two charities to pay back their shares of the award previously granted by the District Court. The District Court denied the motions to reopen and the Court of Appeals for the District of Columbia Circuit affirmed by memorandum order. The Supreme Court denied certiorari.[1]

"In the present case plaintiffs sue the United States under 28 U.S.C. § 1491 for the half of the award paid to the charities on the ground that the Government did not make 'a reasonably diligent search of the records' under Fed. R. Civ. P. 71A(c)(2), so as to discover and ascertain that the Rohleder and Foller interests owned all of the condemned property and were entitled to the entire award (to the exclusion of the charities).[2]

"Defendant moves to dismiss the petition primarily on the ground that the decisions within the D.C. Circuit refusing to reopen the condemnation suit bar, by res judicata or collateral estoppel, maintenance of the present

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[1] The District Court did allow the Foller and Rohleder interests to receive the one-half of the award which had not been distributed to the charities.

Suit has also been brought, thus far unsuccessfully, in the Superior Court of the District of Columbia against the charities to compel them to repay the portion of the award they received. That adverse ruling is now on appeal to the Court of Appeals for the District of Columbia.

[2] For some discussion bearing on the possibility of such a claim under the Tucker Act for inverse condemnation, see 12 Wright and Miller, *Federal Practice and Procedure* (1973) § 3045 at 103; *United States v. 22,680 Acres of Land in Kleberg Co., Tex.*, 438 F.2d 75, 77–78 (5th Cir. 1971); *Philips v. United States*, 151 F.2d 645, 646 (7th Cir. 1945); *United States v. Certain Parcels of Land in Prince George's County*, 40 F. Supp. 436, 443–44 (D. Md. 1941); *United States v. 758.72 Acres of Land*, 24 F.R.D. 271,276 (W.D. Ark. 1959).

action. In support of its motion the Government points out that the District Court, in its decision on the first motion to reopen, said that 'prior to the just compensation proceeding full and adequate notice to all "unknown owners" was given by publication. Fed. R. Civ. P. 71A(d)(3) (ii). There was also actual notice to many of the Foller and Rohleder heirs. None responded. * * * No basis exists for reopening a final judgment where movants had ample notice, slept on their rights for more than a year and failed to present any evidence of extrinsic fraud.' This is said to be a square determination that plaintiffs (and the Foller and Rohleder interests) had full notice of the condemnation proceedings and therefore that the Government must be held to have made 'a reasonably diligent search of the records.'

"The difficulty with this position (as defendant candidly recognizes in its motion to dismiss) is that that District Court went immediately on to add: 'Assuming the Government failed to make a "reasonably diligent search of the records" as required by Fed. R. Civ. P. 71A(c)(2) a separate independent action for just compensation may lie against the United States in the Court of Claims [citing some of the authorities referred to in note 2, *supra*], but that issue is not before this Court.' The Court of Appeals affirmed because it found no abuse of discretion by the District Court, but it specifically added: 'We express no opinion on whether appellants [plaintiffs here] may press their claim in a suit under the Tucker Act * * *.'

"On the basis of their memoranda, we cannot conclude that the District of Columbia federal courts determined anything at all with respect to 'a reasonably diligent search of the records' by the Government under Fed. R. Civ. P. 71A(c)(2). We are not convinced that the District Court decided anything more than that due notice was given by publication to 'Unknown Owners' under Fed.R. Civ.P. 71A(d)(3)(ii). It may be, however, that though due notice is given to 'Unknown Owners' by publication under the latter requirements, the United States could still be liable under the Tucker Act for failing to make the diligent record search which would have specifically revealed the Foller and Rohleder interests as having or claiming a definite interest in the condemned property and therefore as

entitled to personal service (not merely service by publication) under Fed. R. Civ. P. 71A (d)(3)(i). Rule 71A makes a sharp distinction between persons whose names are learned through a reasonably diligent record search, and 'Unknown Owners' who may be served by general publication. That distinction may conceivably ground a claim under the Tucker Act. Although the District of Columbia courts decided that proper notice by publication was given to 'Unknown Owners', they did not determine—as best as we can make out—that a reasonably diligent record search was actually made by the Government in this instance. Accordingly, we reject the defense of *res judicata*/collateral estoppel based on the holdings of the District of Columbia federal courts.[3]

"There remains the legal issue of whether an inverse condemnation claim may be maintained here on the theory that the Government failed to make 'a reasonably diligent search of the records' so as to discover the Foller and Rohleder interests. See the materials cited in note 2, *supra*. Neither party has adequately briefed that question and we refuse to decide it without a more thorough, detailed and careful presentation. Nor can we decide on the present motion (which is based on the defense of former adjudication) the issue of whether the Government in fact made a reasonably diligent search of the records (or whether all the Rohleder and Foller interests had adequate advance actual notice). Our denial of defendant's current motion to dismiss will be without prejudice to the filing by either or both parties, if they so desire, of motions for summary judgment raising the questions of whether (i) an inverse condemnation claim in this court can be grounded on a failure by the Government to make a reasonably diligent search of the records under Rule 71A (c)(2), and/or (2) in this particular case the Government did or did not in fact make such a search (or whether the plaintiffs' interests nevertheless had proper actual notice).

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[3] Defendant also tries to use the determination of the D.C. Superior Court (*supra*, note 1) in the same way, but the issues before that court were quite distinct from those involved in the present suit, let alone the fact that the defendants in the two actions are quite different.

"IT IS THEREFORE ORDERED AND CONCLUDED, without oral argument,[4] that defendant's motion to dismiss is denied without prejudice to motions for summary judgment, as stated above, and the case is returned to the Trial Division."

No. 340–77. JANUARY 27, 1978

Leon Coleman

Court of Claims jurisdiction; tort claim; eminent domain taking; authority of Government agent; constitutional claims outside court's jurisdiction.—On January 27, 1978 the court entered the following order:

Leon Coleman, pro se.

Alan L. Ferber, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"This *pro se* case is before the court, without oral argument, on the defendant's motion to dismiss. The plaintiff, a federal prisoner, alleges that he was transferred to Lewisburg Penitentiary, Lewisburg, Pennsylvania, on October 16, 1976, and that personal property belonging to him was improperly withheld and intentionally destroyed by certain prison officials. He also alleges other violations of his rights under the 1st, 4th, 8th, and 14th amendments resulting from the withholding of his mail, the revelation to a fellow inmate of the contents of a letter by him to the F.B.I., the endangerment of his life resulting from that and other acts, the imposition of cruel and unusual punishment because of a lack of showers and the inability to make telephone calls, and other forms of harassment by prison officials.

"This court has no jurisdiction under 28 U.S.C. § 1491 (1970) over claims sounding in tort such as plaintiff's claims all appear to be. *Vincin v. United States,* 199 Ct. Cl.

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[4] Plaintiffs have asked for oral argument but in the circumstances the court deems it unnecessary at the present stage.

762, 765, 468 F.2d 930, 932 (1972); *Clark v. United States*, 198 Ct. Cl. 593, 597, 461 F.2d 781, 783, *cert. denied*, 409 U.S. 1028 (1972); *Algonac Mfg. Co. v. United States*, 192 Ct. Cl. 649, 663, 428 F.2d 1241, 1249 (1970). Nor is there any other ground on which this court could grant relief. In order for the Government to be liable for the eminent domain taking of property by the United States, the officer taking the property must be authorized to do so. *Cf. United States v. North American Transportation & Trading Co.*, 253 U.S. 330, 333 (1920); *Eyherabide v. United States*, 170 Ct. Cl. 598, 606, 345 F.2d 565, 570 (1965). Nothing appears here to suggest that any eminent domain taking was authorized. Likewise, claims under amendments to the Constitution which do not in themselves grant a right to the payment of money are beyond the limits of this court's jurisdiction. *United States v. Testan*, 424 U.S. 392, 401–02 (1976); *Eastport Steamship Corp. v. United States*, 178 Ct. Cl. 599, 605, 372 F.2d 1002, 1007 (1967).

"IT IS THEREFORE ORDERED AND CONCLUDED that the defendant's motion to dismiss is granted and that the plaintiff's petition is dismissed.*"

No. 351–77. JANUARY 27, 1978

Holy Cross Hospital of
Silver Spring, Inc.

Medicare contract; Court of Claims jurisdiction; amendment of petition to state monetary claim implicit in pleadings; exhaustion of administrative remedies; reopening of intermediary's determination.—On January 27, 1978 the court entered the following order:

Mershon, Sawyer, Johnston, Dunwody & Cole, attorney of record for plaintiff. *Mannes, Meyers, Nadonley & Townsend*, of counsel.

Robert M. Hollis, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

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* It follows from our disposition of the case that plaintiff's Motion to Compel Discovery, received by the Clerk on January 11, 1978, is denied.

Before DAVIS, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

"Plaintiff Holy Cross Hospital has been a provider of medical services under the Medicare Act, and is therefore entitled to reimbursement from the United States for its reasonable costs under the Medicare program. During its fiscal years 1971–1973, plaintiff leased parts of its facilities to a radiologist and a pathologist who used those facilities for their respective practices—treating both in-patients and out-patients (including Medicare-covered patients)—and constituted the hospital's radiology and pathology departments. Under the instructions of its fiscal intermediary (Mutual of Omaha), which implemented a regulation of the Department of Health, Education and Welfare (20 C.F.R. § 405.486(b)(1) (rev. as of 1973)), plaintiff, in its cost reports for 1971–1973, offset the net income from the two leased departments against its reimbursable Medicare costs. On January 28, 1975, Mutual of Omaha issued its notice of program reimbursement (as required by 20 C.F.R. § 405.491(a) (rev. as of 1973)) incorporating this setoff. Plaintiff did not request, as it could if it disagreed in any way with the notice, a hearing before the intermediary until over two years later when (in April 1977) it asked Mutual of Omaha to reopen its determination for 1971–1973. The request to reopen was prompted by the Fifth Circuit's ruling in *Dr. John T. MacDonald Foundation, Inc. v. Mathews*, 534 F.2d 633 (5th Cir. 1976), *rehearing denied*, 554 F.2d 714 (5th Cir. 1977), that H.E.W. had misinterpreted, unfavorably to the provider, its regulation (20 C.F.R. § 405.486(b)(1)) on leased departments of provider-hospitals. Mutual of Omaha rejected this request to reopen on April 25, 1977. This suit was then begun on June 22, 1977.

"Defendant has moved to dismiss the petition. The first ground is that the petition does not assert a monetary claim because it asks only that the case be remanded to Mutual of Omaha (the intermediary) with instructions to reopen plaintiff's cost reports for 1971–1973 and to recompute reimbursement for those years without setting off the net income from the leased radiology and pathology departments. We agree, however, with plaintiff that the

petition, though defective in form, claims entitlement to monies asserted to be contractually owed by the Government to plaintiff. Obviously the end result sought by plaintiff is a payment by the Government, under its contract with plaintiff, *i.e.* one kind of money claim within the ordinary and usual jurisdiction of this court. In this respect the petition compares to that in *Warrior Constructors, Inc. v. United States*, 211 Ct. Cl. 350 (1976), in which, as here, the demand for money was implicit rather than explicit, and the court said that it was the responsibility of the trial judge to order an amendment or more definite statement 'so that the petition will show that the court has jurisdiction without recourse to inference or implication.' The court did not, however, dismiss the petition and we do not do so in this instance.

"Defendant's second argument for dismissal is that plaintiff failed to exhaust its administrative remedies when it did not file a timely request for a hearing by the intermediary on the January 1975 notice of program reimbursement. The regulations (20 C.F.R. § 405.1811) (rev. as of 1976) required that such a request for a hearing be filed within 180 calendar days after the date of the notice of program reimbursement. Plaintiff gives various reasons why it should be excused from this requirement, but we need not reach those contentions at this time. The regulations (20 C.F.R. § 405.1885(a) (rev. as of 1976)) also provide for reopening of an intermediary's determination, on motion of the provider, within 3 years of the date of the notice of program reimbursement. Plaintiff concedes that such reopening is discretionary but urges that it was an abuse of discretion for Mutual of Omaha to refuse to reopen in the face of the Fifth Circuit's decision *Dr. John T. MacDonald Foundation, Inc., supra*, which shows, plaintiff says, that the intermediary's original determination was "inconsistent with the law, regulations * * *."[1] If the substantive ruling in *Dr. John T. MacDonald Foundation*,

[1] *Part A, Intermediary's Manual*, HIM–13 (Part 2), ¶ 2631.2 provides:

'Whether or not the intermediary will reopen a determination, otherwise final, will depend upon whether new and material evidence has been submitted, or a clear and obvious error was made, or that determination is found to be inconsistent with the law, regulations and rulings, or general instructions.'

Inc.—which clearly and directly bears on plaintiff's case—stands solid, the plaintiff has a very substantial case for its claim of abuse of discretion (though we do not definitely decide that question). The Government tells us, however, that the Fifth Circuit has agreed to rehear that case *en banc* on the issue of whether the district court had any jurisdiction of that provider's claim. If the Fifth Circuit *en banc* decides that there was no district court jurisdiction of that case, the panel's substantive ruling will fall away and could not be considered an authoritative interpretation of the law or the regulations.[2] It is appropriate therefore that we await the ultimate ruling of the Fifth Circuit on the jurisdictional issue before passing upon defendant's point that plaintiff has failed to exhaust its administrative remedies.

"IT IS THEREFORE ORDERED AND CONCLUDED that defendant's motion to dismiss is denied (without prejudice to proper measures by the trial judge to obtain a non-defective petition) insofar as it urges that the petition fails to state a monetary claim and on the issue of failure to exhaust administrative remedies the motion is denied without prejudice to renewal after the conclusion of the judicial proceedings in *Dr. John T. MacDonald Foundation, Inc., supra.*"

On April 17, 1978 the Fifth Circuit sitting *en banc* *vacated* the decision in *Dr. John T. MacDonald Foundation, Inc. v. United States,* reported 534 F.2d 633. *See* 571 F.2d 328. On July 15, 1978 defendant filed a petition for a writ of certiorari.

On June 26, 1978 plaintiff filed an amended petition stating a monetary claim.

On July 24, 1978 defendant filed a motion to suspend proceedings pending Supreme Supreme Court action on the petition for certiorari.

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[2] One of the intermediary's grounds for refusing to reopen here was that the *Dr. John T. MacDonald Foundation, Inc.* court was without jurisdiction to review the administrative agency's action.

No. 354-77. JANUARY 27, 1978

John Tarkowski

Court of Claims jurisdiction; constitutional claims.—On January 27, 1978 the court entered the following order:

John Tarkowski, pro se.

Arlene Fine, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"Defendant has moved to dismiss the petition of plaintiff who is before the court *pro se.* Plaintiff presents the court with a long litany of complaints and demands for redress, based principally upon his alleged constitutional rights. His claim falls into three main groups.

"First, plaintiff complains of actions taken by authorities of the State of Illinois, beginning in 1965. It is not intended that his complaint be repeated here in detail but it pertains, generally, to allegedly malicious suits against plaintiff for enforcement of deed restrictions and zoning requirements, his imprisonment in solitary confinement, confiscation of his property, and his inability to obtain redress in Illinois courts or assistance from a county attorney or the State's attorney general.

"Second, plaintiff complains of actions taken and not taken by Congress, the Supreme Court, and the Attorney General of the United States, to represent him and to defend and perfect his constitutional rights against the tyranny of Illinois and the federal bureaucracy.

"Third, plaintiff alleges that Legal Aid offices have failed in their duties to him 'forcing plaintiff to become a lawyer to defend himself and his constitutional rights.'

"Plaintiff seeks compensatory damages of $360,000 for loss of health, liberty, property, and for mental anguish, incarceration, and conspiracy. He seeks $5 million in antitrust damages for violations in connection with the activities of the Legal Aid offices. He also seeks mandamus compelling Legal Aid to furnish him counsel; mandamus directing the Supreme Court to give him a trial or review his legal problems; mandamus directing Congress to award

him $5 million and to withhold federal funds from the State of Illinois. He also demands certain legislation by Congress and the posting of a $1 million dollar bond to prevent further 'rape' of his constitutional rights.

"Upon patient and careful consideration of each of plaintiff's claims, and viewing them in the light most favorable to him, we conclude that he has not stated a claim on which relief can be granted by this court of limited jurisdiction nor has plaintiff cited any case to us which aids his cause. The cases he has cited are inapposite.

" 'The Court of Claims is a special tribunal established to hear and determine suits against the United States on claims of specified classes. Except as Congress has consented, there is no right to bring these suits against the United States, and therefore the right arising from the consent is subject to such restrictions as Congress has imposed.' *Luckenbach S.S. Co.* v. *United States,* 272 U.S. 533, 536 (1926). *See also United States* v. *Testan,* 424 U.S. 392 (1976); *United States* v. *King,* 395 U.S. 1 (1969); *Eastport S.S. Corp.* v. *United States,* 178 Ct. Cl. 599, 372 F.2d 1002 (1967).

'IT IS THEREFORE ORDERED, upon consideration of the petition, the motion, and plaintiff's response thereto, without oral argument, that defendant's motion to dismiss is hereby granted. The petition is dismissed."

Plaintiff's motion for reconsideration was denied April 4, 1978.

No. 387-77. JANUARY 27, 1978

Erma M. Schrader

Court of Claims jurisdiction; taxes; comity.—On January 27, 1978 the court entered the following order:

Erma M. Schrader, pro se.

Michael J. Dennis, with whom was *Assistant Attorney General M. Carr Ferguson,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"This claim for refund of federal income taxes comes before the court on defendant's motion to dismiss for lack of jurisdiction. Rule 38(b). Plaintiff claims that the Internal Revenue Service caused her to pay taxes not properly due by denying legitimate deductions and requiring her to file singly instead of jointly with her now deceased husband.

"Defendant has informed us that plaintiff has litigated her liability for 1970 taxes in the Tax Court. The decision, reported at 34 T.C.M. (CCH) (1975), was favorable to plaintiff on the issue of depreciation of an air conditioner and on the amount of loss to be recognized on the sale of a laundromat whose equipment included the air conditioner. The scope of the issues litigated in that case is not clear, there having been some narrowing of the issues from the time she filed her petition at the Tax Court to the time of decision there. See 34 T.C.M. at 1577. Yet the scope of the Tax Court proceedings is immaterial, except for the tax year involved. 26 U.S.C. § 6512(a) (1970) provides, with exceptions not applicable here, that where a taxpayer receives a notice of income tax deficiency and files suit in the Tax Court, no suit may be entertained by other courts concerning the taxpayer's income tax obligations for that same year. Accordingly, plaintiff's Tax Court suit (now on appeal to the Sixth Circuit) leaves this court without jurisdiction to hear her claim. Further, we have not been shown that plaintiff has filed a timely refund claim, a prerequisite to our jurisdiction. 26 U.S.C. § 7422(a) (1970).

"IT IS THEREFORE ORDERED, upon the parties written submissions but without oral argument, that defendant's motion to dismiss for lack of jurisdiction is granted. Plaintiff's petition is dismissed."

JANUARY 27, 1978

No. 478–77 American Manufacturing Co. of Texas
No. 479–77 Industrial Park Supply Co.
No. 480–77 General Industrial Corp.

Renegotiation of contracts; amount of bond to stay execution of orders of Renegotiation Board; effect of tax credits.—On January 27, 1978 the court entered the following order:

James J. Gallagher, attorney of record, for plaintiffs. *D. Joe Smith, Jr.*, and *Sellers, Conner & Cuneo*, of counsel.

Gerald L. Schrader, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant. *Don Crockett, Renegotiation Board*, of counsel.

Before DAVIS, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

"This matter before the court concerns the filing of a bond to stay execution of orders of the Renegotiation Board entered on June 29, 1977, determining plaintiffs' excessive profits to be $9,125,000 for the years 1966–71. On September 27, 1977, plaintiffs filed suit seeking a determination that their respective profits were not excessive. On October 11, 1977, plaintiffs filed a motion requesting that the court rule that their bond should be set in an amount $442,363 less than that required by Rule 26. The basis of the motion was that plaintiffs disagreed with the IRS computations about their tax credits. Simultaneously with their motion, plaintiffs submitted to the clerk of the court a bond which was $442,363 less than the net amount of excessive profits as determined by the board. Defendant then filed a motion for judgment in aid of execution of the board's orders and opposed plaintiffs' motion of October 11.

"In an order issued December 20, 1977, Trial Judge Mastin G. White denied plaintiffs' motion of October 11, saying:

> *Provided, however,* That the denial of the pending motion is without prejudice to the filing hereafter by the plaintiffs (having first filed a bond complying fully with paragraph (b) of Rule 26) of a motion seeking relief under paragraph (e) of Rule 26 with respect to recomputation of their section 1481 credits.

"The trial judge certified his ruling to the court for review. Defendant requested prompt review and opposes the trial judge's order as contrary to Rule 26 and 50 U.S.C. App. § 1218 (Supp. V 1975).

"We have carefully considered the representations of the parties in this matter, believe that the trial judge was correct and believe that the legitimate interests of defend-

ant will be fully protected if plaintiffs post the bond required by Rule 26(b). This is not the proper time to determine plaintiffs' tax credits. *Manufacturers Serv. Co.* v. *United States*, 207 Ct. Cl. 185, 194, 518 F.2d 1202, 1207 (1975).

"IT IS THEREFORE ORDERED that the relief demanded in defendant's request for review is denied without prejudice. Defendant's motion for judgment is denied without prejudice. The order of the trial judge is affirmed. Plaintiffs are directed to file a bond or bonds in conformity with the rule forthwith. Upon their failure to do so, the court will entertain a renewal of defendant's motion for judgment in aid of execution."

No. 598–71. FEBRUARY 3, 1978

Mancon Liquidating Corporation

Renegotiation of contracts; redetermination of excessive profits; suspension of proceedings to await District Court determination of liability of others than named party.—On February 3, 1978 the court entered the following order:

David B. Brown, attorney of record, for ICC, IMCO-DC. *David R. McAtee* and *Thompson, Knight, Simmons & Bullion, James H. McGlothlin* and *Covington & Burling*, of counsel.

Elizabeth Langer, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant. *Gerald D. Freed*, of counsel.

Before DAVIS, *Judge*, Presiding, KASHIWA and KUNZIG, *Judges*.

"The underlying case in this court involves the petition of Mancon Liquidating Corporation to redetermine excessive profits under the Renegotiation Act, 50 App. U.S.C. § 1211 *ff.*, for its fiscal year ended July 31, 1967. That case has not yet been tried on its merits, and our present concern is not with the merits but with questions of who shall be liable if Mancon—which the Government calls a worthless shell—is found to have made excessive profits. In February 1977 the trial judge allowed the defendant's

motion that third-parties International Controls Corporation (ICC) and Intercontinental Manufacturing Company, Inc. (IMCO-DC) be served with notices to appear and assert any claim or interest they might have in the Mancon proceedings; the Government asserts that ICC and IMCO-DC have such an interest because, it is said, they assumed Mancon's renegotiation liability in connection with their acquisition of assets and liabilities of Mancon. The Government had taken the same position in a civil action it brought, in December 1976, against ICC and IMCO-DC in the Northern District of Texas to make those entities liable for any renegotiation liability found against Mancon. *United States v. International Controls Corp.*, et al., C.A. No. 3–76–1653–F, N.D. Tex.

"IMCO-DC and ICC then moved to stay the proceedings in this court (except as to discovery between Mancon and the Government) until the Texas District Court had resolved the issue of movants' liability. They asserted that unless that was done they would be compelled to participate on the merits in this court (Mancon being reportedly insolvent and without incentive to protect its own interest) even though it might very well turn out that they were not liable, as transferees or otherwise, for any of Mancon's excessive profits. The Government agrees that the liability of ICC and IMCO-DC should be determined before the merits of the renegotiation claim is gone into.

"The trial judge denied the motion of ICC and IMCO-DC. He thought that 'on the limited facts now available to this court it is plausible to identify both ICC and IMCO-DC, not as parties upon whom liability might devolve by operation of law (*i.e.*, as transferees), but as the real parties in interest in this suit. The latter situation may exist by virtue of a constructive novation pursuant to which ICC and/or IMCO-DC were joined with or substituted as the "contractor" on Mancon's contracts with the Government.' The trial judge also said: 'Since this court clearly has jurisdiction to determine whether, as a matter of contract law, the present action has been brought by the real party in interest, the granting of a request for stay would be inappropriate.'

"ICC and IMCO-DC have sought review of this denial of their motion to stay. The trial judge has certified the matter under Rule 53(c)(2)(i), and we have heard oral argument.

"Before us the parties have disputed (a) the jurisdiction of this court to consider and decide all or any of the grounds upon which ICC and IMCO-DC might be liable for Mancon's renegotiation debt (if any), and (b) whether ICC and IMCO-DC are so liable as a matter of fact and law. We by-pass those issues entirely, without intimating any opinion on them, because we are satisfied that as a matter of comity this court ought to wait for the determination in the Northern District of Texas. Our underlying premise, which we share with the participants in this request for review, is that the liability of ICC and IMCO-DC should be decided before this court considers the merits of the issue of excessive profits.

"The first and most important reason for waiting for the Texas tribunal is that there is very little doubt that that District Court has jurisdiction to decide the issues involving the liability of ICC and IMCO-DC for excessive profits found to be due in the suit in this court.[1] The jurisdiction of this court over those problems, on the other hand, is strongly contested by ICC and IMCO-DC and raises at least a substantial question. It is preferable in that situation to have the issues decided in the court with the clearest claim and least doubt as to jurisdiction. *Cf. Georgia-Pacific Corp. v. United States, ante,* at 361–64.

"A second reason for waiting for the District Court is that, for litigation purposes, the problems relating to the potential liability of ICC and IMCO-DC first arose when the Texas suit was commenced by the Government in December 1976. It was not until a month or two later that the Government moved in this court for third-party notices to ICC and IMCO-DC. It is true that the renegotiation suit itself had been begun several years before, but the effort to obtain a judicial determination of the potential liability of

[1] At the oral argument, Government counsel sought to question the jurisdiction of the District Court but we are not at all persuaded that the Government was wrong when it brought its suit in Texas and thus asserted that that court had full jurisdiction.

ICC and IMCO-DC did not begin until December 1976 and it first came in the Northern District of Texas.

"Third, we have, at this stage, no good reason to believe that the determination of the matter in the Northern District of Texas will be unduly delayed. From what we know now, that court's ruling could come as swiftly as a comparable decision by this court. If it should turn out that there is undue delay, this order will not preclude any party from asking the court to lift the suspension and to authorize proceedings in this court to commence again.

"IT IS THEREFORE ORDERED AND CONCLUDED that the request for review by ICC and IMCO-DC is granted, the trial judge's order is vacated insofar as it denied the stay of proceedings requested by ICC and IMCO-DC, and further proceedings in this court are stayed (except for discovery between Mancon and the Government) until the decision in *United States v. International Controls Corp., et al.*, C.A. No. 3–76–1653–F, N.D. Tex., *supra*."

No. 56–76. FEBRUARY 3, 1978

Carl W. Ramsey

Military pay; limitation of actions; accrual of cause of action for wrongful discharge.—On February 3, 1978 the court entered the following order:

Thomas H. King, for plaintiff. *Charles M. Munnecke*, attorney of record. *Charles A. Jonas, King, Everhard and Kiefer*, and *Jonas & Jonas*, of counsel.

George M. Beasley, III, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, *Judge*, Presiding, KASHIWA, and KUNZIG, *Judges*.

"This military pay case comes before the court on defendant's motion to dismiss and plaintiff's motion for summary judgment. Plaintiff seeks to have this court rescind the resignation which he submitted 'for the good of the service and in lieu of court-martial' on February 17, 1942. In place of that resignation, plaintiff prays for judgment restoring him to the retired list and entitling

him to retired pay from February 17, 1942. Defendant moves to dismiss the petition on the ground that it was filed in February 1976 and is barred by the six-year statute of limitations applicable here. 28 U.S.C. § 2501 (1970). It is clear that plaintiff's claim accrued upon discharge (*Mathis v. United States*, 183 Ct. Cl. 145, 391 F.2d 938 (1968); *Kirby v. United States*, 201 Ct. Cl. 527, 531 (1973), *cert. denied*, 417 U.S. 919 (1974)), and that the instant petition was filed more than six years thereafter. Plaintiff relies upon disability retirement cases holding that that type of claim accrues upon the action of the first competent board (*Friedman v. United States*, 159 Ct. Cl. 1, 310 F.2d 381 (1962), *cert. denied, sub nom. Lipp, 373 U.S. 932 (1963); Harper v. United States*, 159 Ct. Cl. 135, 310 F.2d 405 (1962), but *Mathis* and *Kirby* have made it clear that the rule is different for wrongful discharge cases and that in the latter class of case the cause of action accrues all at once upon the serviceman's removal. Plaintiff's later applications for Correction Board relief, which ultimately proved unsuccessful, did not toll or defer the statute of limitations; those applications were permissive, not mandatory. See *Mathis, supra*, 183 Ct. Cl. at 147–48, 391 F.2d at 939; *Kirby v. United States, supra*, 201 Ct. Cl. at 531–32. Plaintiff's claim, in short, had long been barred by limitations when he first sought relief through the Correction Board in the 1970's. Even if the Secretary, in denying relief and refusing to follow the Correction Board's recommendation, acted wrongfully toward plaintiff, the judicial claim vindicable in this court had previously expired and the Secretary's negative action would not create a 'new' claim. See *Eurell v. United States, ante* at 281, n. 5.

"IT IS THEREFORE ORDERED, upon consideration of the briefs and exhibits, and after oral argument, that plaintiff's motion for summary judgment is denied and that defendant's motion to dismiss is granted. The petition is dismissed."

Plaintiff's motion for reconsideration *en banc* was denied April 27, 1978.

No. 190–76. FEBRUARY 3, 1978

Octavio Carrasco, Jr., et al.

On motions for rehearing.—On February 3, 1978, the court entered the following order on the parties' motions for rehearing respecting the opinion reported *ante* at 19:

"Both plaintiffs and defendant have filed petitions for rehearing of the opinion and decision in this case which were promulgated on October 19, 1977. Defendant asks for rehearing *en banc.* A majority of the active judges of the court have not voted to grant the defendant's suggestion for rehearing *en banc.* The rehearing petitions have therefore been considered under Rule 151 by the above panel.

"Except for the matter discussed in the next paragraph, the court denies both petitions for rehearing.

"With respect to the portion of defendant's rehearing petition relating to plaintiff Martin, the court grants the petition to that extent, and amends the opinion of October 19, 1977 as follows:

"At the end of the last paragraph of the opinion (prior to "Conclusion") the following new footnote[7] is inserted:

> [7] Plaintiff Martin is not entitled to be retroactively slotted in GS–16, a supergrade. Under 5 U.S.C. §§ 3324(a) and 5108(a), no placement in a supergrade position can be made without the prior approval of the employee's qualifications by the Civil Service Commission. The Commission has emphasized in its regulations this requirement of prior approval. 5 C.F.R. § 305.505(b); see, also, Federal Personnel Manual, chap. 305, subchapter 3–3(f). Retroactive approval is not permissible. See 56 Comp. Gen. 432 (1977). Obviously, no such prior approval was obtained for Martin on his return to IRS. Accordingly, Martin cannot now be slotted, for the purposes of this suit, at any grade higher than GS–15; if the steps of that grade do not suffice to give him IRS pay at least equal to his FTAS pay, he is barred from recovery by the legislation relating to supergrades which control and override IRM § 183(10).9(2).

"IT IS SO ORDERED."

No. 102-76. FEBRUARY 3, 1978

Peerless Coal Company

Eminent domain; claim of Fifth Amendment taking; motion for summary judgment; material issues of fact present.—On February 3, 1978 the court entered the following order:

J. S. Daily, attorney of record for plaintiff. *Daily, West, Core and Coffman,* of counsel.

C. David Redmon, with whom was *Assistant Attorney General Peter R. Taft,* for defendant.

Before NICHOLS, *Judge,* Presiding, COWEN, *Senior Judge* and BENNETT, *Judge.*

"Plaintiff is the owner of 883.89 acres of land and alleges that from 1948 to the present time the government has continued to obtain through negotiation and condemnation, successive one-year leases. In the government's last action for condemnation which was filed in the United States District Court for the Western District of Arkansas in 1974, plaintiff filed a counterclaim on the grounds that the government had taken a fee interest in its property and that it is entitled to just compensation therefor pursuant to the Fifth Amendment.

"Upon defendant's plea that the Court of Claims has sole jurisdiction of the cause of action alleged in the counterclaim, the District Court transferred the case to this court, pursuant to 28 U.S.C. § 1406.

"The case now comes before this court on Plaintiff's Motion for Summary Judgment and on Defendant's Cross-Motion for Summary Judgment.

"After considering the motions and briefs of the parties and after hearing oral argument, the court finds that plaintiff expects to amend its petition by alleging:

"1. That the government was guilty of bad faith or abused its discretion in determining the extent of the estate in plaintiff's lands that should be taken, the government having intended at all times to retain the land permanently for the use of Fort Chaffee; and

"2. That as a result of the heavy contamination of plaintiff's land by irremovable unexploded artillery shells

thereon, the government has destroyed the value of the land for its highest and best use and has in fact appropriated the land for itself.

"The court concludes that such proposed amendments, together with the documentary evidence attached to plaintiff's motion raise material issues of fact which cannot be decided on motions for summary judgment. See the court's order issued December 20, 1974 in *Southern California Financial Corp. v. United States*, No. 79–74; *United States v. 64.88 acres in Alleghany County*, 244 F.2d 534 (3rd Cir. 1957); *Simmonds v. United States*, 199 F.2d 305 (9th Cir. 1952); *United States v. Meyer*, 113 F.2d 387 (7th Cir. 1940); *Castro v. United States*, 205 Ct. Cl. 534, 500 F.2d 436 (1974); *Drakes Bay Land Co. v. United States*, 191 Ct. Cl. 389, 424 F.2d 574 (1970); and *Eyherabide v. United States*, 170 Ct. Cl. 598, 345 F.2d 565 (1965).

"Defendant's argument that plaintiff's proposed claims of bad faith or abuse of discretion are cognizable only in the United States District Court are hereby rejected on the ground that the plaintiff's claim was transferred to this court on motion of the United States; that the order was never appealed from and is now final, and that it is the law of the case.

"IT IS THEREFORE ORDERED that the parties' cross-motions for summary judgment are denied; that plaintiff shall have 30 days from this date for amending its petition in the respects stated above, and that the case is hereby remanded to the Trial Division for trial or other disposition of all issues raised by plaintiff's amended petition and defendant's answer thereto."

No. 392–76. FEBRUARY 9, 1978

James M. Ellis and Windell G. Malpass

Civilian pay; failure to exhaust administrative remedies; reduction-in-force.—On February 9, 1978 the court entered the following order:

David T. Lopez, attorney of record, for plaintiffs. *David T. Lopez & Assoc.*, of counsel.

Robert M. Hollis, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, NICHOLS and KASHIWA, *Judges.*

"The petition covers two employees of NASA's Johnson Space Center who were reduced-in-force in 1970; claiming that their reductions-in-force were improper and illegal, each seeks back pay and reinstatement. Defendant has moved for summary judgment as to both plaintiffs. In this order we dispose of the claim of plaintiff Malpass but not of plaintiff Ellis.

"Malpass's reduction-in-force became effective September 30, 1970. He never took any appeal to the Civil Service Commission—an administrative remedy which he had as of right—but a few days less than six years later he filed this suit on September 28, 1976. We have held that employees separated from civilian positions with the Federal Government, who have a right of appeal to the Civil Service Commission, must pursue that remedy. See *Wilmot v. United States,* 205 Ct. Cl. 666, 680–81 (1974); *Krennrich v. United States,* 169 Ct. Cl. 6, 8–9, 340 F.2d 653, 654, *cert. denied,* 382 U.S. 870 (1965).

"Malpass's written notice of reduction-in-force stated expressly that he could appeal the action to the Commission 'at any time after receipt of this notice but not more than fifteen (15) calendar days after the effective date of the action.'[1] However, an affidavit filed by his attorney in this action says that Malpass told the attorney that 'he was not informed of any right of appeal * * * after he had been [orally] told of the RIF, he contacted the Civil Service Commission and inquired about rights of appeal. He stated that he was told by the Commission's office in Houston that if he was not a veteran the Commission was not required to give him a hearing. He stated to me [the attorney] that he interpreted this to mean that he did not have a right of

[1] The notice (dated August 19, 1970) went on to say:

'The appeal must be in writing and should set forth your specific reasons for contesting this action with offer of proof and such pertinent documents as you are able to submit.'

appeal to the Commission, and he further stated that he did not know any different until he contacted my [the attorney's] office for the purpose of filing this action in the Court of Claims.'

"Even if we were to accept the attorney's hearsay affidavit as sufficiently probative, we could not excuse Malpass for failing to exhaust his Commission remedy. The written RIF notification gave him explicit confirmation that an appeal did lie to the CSC,[2] and at the time Malpass was a Materials Engineering Technician, grade GS–11. We cannot believe that, in the face of this explicit written statement, it was due care for one of his rank to rely on an oral statement over the telephone that as a non-veteran he was not entitled to an oral hearing as meaning that he had no right to any appeal at all.[3] He could and should have pursued the matter further if he had doubts as to his right to appeal. There is here no such justification for failure to exhaust the administrative remedy as was found in *Shubinsky v. United States*, 203 Ct. Cl. 199, 488 F.2d 1003 (1973) and *Ainsworth v. United States*, 180 Ct. Cl. 166 (1967). Accordingly, we hold that Malpass failed, without adequate justification, to pursue his mandatory administrative remedy.

"Ellis did appeal to the Civil Service Commission and is therefore in a different position from Malpass. As to him, the petition asserts, *inter alia*, that subsequent to the reduction action the duties which had been performed by him continued to be performed by personnel employed by NASA contractors, in violation of both the applicable NASA regulations and the governing standards promulgated by the Civil Service Commission. Defendant insists and the Commission held that, even if these regulations and standards were violated, Ellis's reduction-in-force was proper and he has no right to back pay or reinstatement. See, to this general effect, *A.F.G.E. v. Hoffman*, N.D. Ala. Civ. No. 75–G–0652–NE (Aug. 12, 1976). However, the

[2] The attorney's affidavit says that Malpass was informed orally of the RIF but there is no statement, and no indication, that he did not receive the official written notification.

[3] The advice given Malpass was correct. As a non-veteran, he was not entitled as of right to an oral hearing but he was entitled to make a written appeal to the Commission.

District Court for the District of Columbia has recently indicated to the contrary. *A.F.G.E. v. Administrator, NASA*, Civil Action No. 76–1821 (D.D.C., Aug. 12, 1976). The latter case has been appealed to, and argued before, the U.S. Court of Appeals for the D.C. Circuit, but has not yet been decided. In these circumstances, it is appropriate to suspend proceedings here to await the ruling of the D.C. Circuit.

"IT IS THEREFORE ORDERED AND CONCLUDED that defendant's motion for summary judgment is granted as to plaintiff Malpass and the petition is dismissed as to him, but that with respect to plaintiff Ellis further proceedings on defendant's motion for summary judgment are suspended until after the D.C. Circuit's decision in *A.F.G.E. v. Administrator, NASA, supra*."

No. 398–76. FEBRUARY 3, 1978

Proctor Wholesale Company, Inc.

Water pollution; oil spill clean-up costs; dismissal of counterclaim.—On February 3, 1978 the court entered the following order:

Richard W. Boone, attorney of record for plaintiff. *Carr, Jordan, Coyne & Savits*, of counsel.

Mark J. Hardcastle, for Third Party City of Hickory; *Robert D. Courtland*, attorney of record. *Levitan, Ezrin, Cramer, West and Weinstein, Suzanne M. Snedegar, Tate, Young and Morphis* and *E. Murray Tate, Jr.*, of counsel.

Michael P. Carlton, with whom was *Assistant Attorney General James W. Moorman*, for defendant.

Before DAVIS, *Judge*, Presiding, KASHIWA and KUNZIG, *Judges*.

"Proctor Wholesale Company sues to recover, under Section 311(i)(1) of the Federal Water Pollution Control Act, 33 U.S.C. § 1321(i)(1) (Supp. V, 1975), its costs of removing spilled oil from United States waters. Both the plaintiff and the United States have moved for summary judgment and the case, which has been argued orally, is ready for disposition.

"The facts are these: On October 12 or 13, 1975, about 4,000 gallons of asphalt conditioner were discharged from an oil storage tank (a converted railroad tank car) located on property owned by plaintiff which had been purchased from the City of Hickory, North Carolina, some forty days prior to this incident. A large amount of the spilled asphalt conditioner found its way into Horseford Creek, Hickory, and from there into Lake Hickory, an impoundment of the Catawba River. The discharge apparently occurred through the opening by an unknown third party—presumably a vandal—of the valve in the storage tank. Proctor Wholesale was responsible for most of the clean-up effort and says it incurred over $12,500 in that work.

"The statute provides that the owner or operator of an onshore facility from which oil or a hazardous substance is discharged into United States waters who acts to remove the oil or substance from those waters shall be entitled to his reasonable costs 'upon establishing, in a suit which may be brought against the United States Government in the United States Court of Claims, that such discharge was caused solely by (A) an act of God, (B) an act of war, (C) negligence on the part of the United States Government, or (D) an act or omission of a third party * * *.' Plaintiff relies here on subsection (D), *i.e.* an act or omission of a third party.

"No doubt a third party was involved in the spill but the critical issue is whether the discharge was caused "solely" by that third party's act or whether the plaintiff was at least partially responsible. In *City of Pawtucket v. United States*, 211 Ct. Cl. 324 (1976), the court made it clear that a claimant cannot recover, even if a vandal or third party immediately caused the spillage, if the claimant does not prove that it acted reasonably to prevent or forestall such intervention by the third party. The burden of proof lies on the claimant.

"We find that Proctor Wholesale did not exercise the required level of reasonable care. The spill occurred about forty days after plaintiff acquired the property, with two oil tanks on it, from the City of Hickory. Apparently plaintiff did not even trouble to ascertain for sure what the tanks

contained, although it was quite aware of their existence.[1] And although Proctor was also aware that third persons could gain access to the property and the tanks, it took no action prior to the spill to restrict or prevent such access to the area on which the tanks were located. There was no fence around the tanks or the property, there was no external lighting on the property to help prevent vandalism, and the area was not patrolled by police or other security personnel. Nor was there any dike or berm around the tanks to retain oil accidentally or intentionally discharged from the tanks. Moreover, the company was clearly on notice from the type of the tanks that they might well contain oil or a comparable substance. Yet nothing whatever was done in the forty days after the property on which the tanks stood was transferred from the City of Hickory to Proctor. Forty days is not too short a period within which a property owner should take preventive action against spillage of oil (or a comparable substance) located on its property.

"The result is that, here as in *City of Pawtucket, supra*, 'it was the omissions of plaintiff which gave the third party easy access to the tank area and created a situation conducive to vandalism,' and 'it cannot be said that a vandal was the sole cause of the spill within the meaning' of the statute. Because of its total and negligent inaction for a period of more than a month, plaintiff has failed to establish that the discharge was caused 'solely' by an act or omission of a third party.

"IT IS THEREFORE ORDERED AND CONCLUDED that defendant's motion for summary judgment is granted, plaintiff's cross-motion for summary judgment is denied, and the petition is dismissed.[2]"

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[1] Plaintiff asserts that the City of Hickory was negligent in failing to remove the oil or to inform plaintiff of its presence. We do not resolve that issue for it is clear that, even if the City was negligent, plaintiff was itself lacking in due care in failing to find out what was in the tanks and in failing to take any precautions against spillage.

[2] Our disposition also entails the dismissal of the counterclaim of third-party City of Hickory against plaintiff. See *Rolls-Royce, Ltd. v. United States*, 176 Ct. Cl. 694, 364 F.2d 415 (1966). The rights *inter se* of plaintiff and the City of Hickory will have to be resolved in some other forum.

No. 466-76. FEBRUARY 3, 1978

Norman Casper

Contracts; implied-in-fact contracts; basis for; injunctive powers of court; breach damages; alleged IRS informant.—On February 3, 1978 the court entered the following order:

Alan E. Wolin, for plaintiff. *Jack B. Solerwitz,* attorney of record.

Vincent M. Garvey, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KASHIWA and KUNZIG, *Judges.*

"Plaintiff Casper's petition asserts in substance that he was a paid confidential informant (working under the code name of T.W. 24) for the Internal Revenue Service, especially with regard to matters in the Bahamas; that his identity was wrongfully disclosed by the then Commissioner of the Internal Revenue Service at a press conference at which the Commissioner disclosed sufficient material facts so that anyone familiar with T.W. 24 or with his activities would know his true identity; that as a result of this disclosure plaintiff suffered severe damage to his business in the Bahamas and to his personal safety; and that the Commissioner's action was a breach of an implied contract plaintiff had with the United States to maintain his confidential status. He seeks large damages and an injunction against any further dissemination of information regarding him.

"Defendant has moved to dismiss, plaintiff has filed a cross-motion for summary judgment, and oral argument has been had.

"Casper founds his claim of a contract implied in fact on certain provisions of the IRS Handbook and Manual for Special Agents, dealing with the status of confidential informants. But we need not decide whether those provisions could create any implied contract, and if so of what nature, because at the oral argument plaintiff's counsel, under inquiry from the bench, refused to represent to the court that plaintiff was in any way aware of these

provisions (or their substance) when he undertook the role of confidential informant. Without some knowledge on Casper's part that the Government had agreed to maintain his confidentiality if he undertook to be a confidential informant, there could be no contractual arrangement with the Government, express or implied. Since plaintiff has moved for summary judgment, it is his burden to at least assert in definite form that he understood or expected or knew that his confidentiality would be maintained by the Government if he became an informant.[1]

"In view of this cardinal defect in plaintiff's case it is unnecessary to go further but we add that, in any event (i) we have no jurisdiction to grant the injunction plaintiff seeks (*United States v. King*, 395 U.S. 1 (1969); *Glidden Co. v. Zdanok*, 370 U.S. 530, 557 (1953));[2] and (ii) the loss-of-business damages plaintiff asks us to award seem beyond those normally allowable for breach of contract (see *Northern Helex Co. v. United States*, 207 Ct. Cl. 862, 886–88, 524 F.2d 707, 720–21 (1975); *William Green Constr. Co. v. United States*, 201 Ct. Cl. 616, 626, 477 F.2d 930, 936 (1973)).

"IT IS THEREFORE ORDERED AND CONCLUDED that defendant's motion to dismiss is granted, plaintiff's cross-motion for summary judgment is denied, and the petition is dismissed."

Plaintiff's motion for rehearing was denied on April 4, 1978.

No. 508–76. FEBRUARY 9, 1978

Isidora Leon Minor

Taxes; income tax; income subject to taxation; community property; foreign spouse.—On February 9, 1978 the court entered the following order:

Isidora Leon Minor, Pro se.

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[1] Plaintiff filed no such affidavit or statement. Even the petition does not allege that plaintiff knew of any Government pledge of confidentiality; it merely says that the Government maintained a right of confidentiality over a period of many years.

[2] Pub. L. No. 92–415, Act of August 29, 1972, 88 Stat. 652, amending 28 U.S.C. § 1491, does not grant this court injunctive power of the type plaintiff seeks to invoke.

Marc Levey, with whom was *Assistant Attorney General M. Carr Ferguson*, for defendant. *Theodore D. Peyser*, of counsel.

Before DAVIS, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This tax case is before us on defendant's motion for summary judgment. Plaintiff is a woman, a Spanish national, who has never emigrated to the United States nor been resident here. Before 1975, the tax year involved, she married James L. Minor, Jr., a citizen of the United States and domiciliary of Kentucky, who was a member of the U. S. Armed Forces. The marriage, she says, was 'consummated' in Spain (she probably means performed) and there was no agreement concerning property rights. She says that her husband's pay is community property and half of it belongs to her; therefore she claims refund of the income tax defendant assessed and collected on her half. Since defendant does not argue otherwise, we assume plaintiff has filed an adequate claim for refund and is the proper person to prosecute the suit.

"She attached to her petition and relies on a purported translation of the applicable Spanish statutes, Arts. 1315 and 1325 of the Spanish Civil Code. By Art. 1315 all marriages are contracted under the legal system of community property, unless the parties make a prenuptial agreement to the contrary. Art. 1325 prescribes a further exception. If, *in a foreign country* a Spanish male marries a foreign female, without pre-nuptial agreement, the marriage comes under the community property system, but if a Spanish female marries a foreign male, 'the marriage will come under the general law in the country of the husband.' Plaintiff does not contend that Kentucky is a community state. She says that Art. 1325 has no application because the marriage was performed in Spain. Clearly, if this is all, it would appear that Spanish law does indeed impute half of the husband's income to the wife, without regard to whether he is or is not domiciled in Spain. He could be just a tourist there, with the same result.

"Defendant's motion simply ignores plaintiff's exposition of the Spanish law and on the other hand imputes to plaintiff a contention she does not make, that her husband somehow became domiciled in Spain. This straw man defendant effectively demolishes.

"Rule 125 of this court deals with the determination of foreign law. It states that in determining foreign law, the court may consider any relevant material or source, including testimony. But a question of foreign law is to be treated as a question of law. This does not mean that the court may be denied both the help of testimony, as was mandatory under old law, and the briefing and arguing that is customary when it is a matter of domestic law. We know what plaintiff thinks the Spanish law demands. We are entitled to know what defendant's views in the premises are. Plaintiff has raised an important issue in the administration and scope of the internal revenue laws. She cites an unpublished Tax Court decision defendant doubtless knows all about. We are not required to research all these matters unaided.

"There may be relevant provisions of the Status of Forces agreements. If Spain really claims that the marriage of an American serviceperson, performed in Spain, to a Spanish national, regardless of domicile, automatically and by itself removes half the serviceperson's pay from American to Spanish taxing jurisdiction, that would appear at first blush to be a serious matter that we should not decide on the basis of inadequate information.

"Plaintiff obviously cannot come here to try her case, in which she appears *pro se*. The refund she claims is only $294.02, before interest. If defendant can disclose its knowledge of the matter, and its views, fully and candidly, perhaps we can decide the case fairly without appointing counsel to represent plaintiff without charge to her.

"Defendant's motion for summary judgment is denied without prejudice to a new one prepared in accordance with the foregoing opinion."

No. 183-77. FEBRUARY 3, 1978

Litton Systems, Inc.

Pleading and practice; fraud defense; scope of discovery re civil v. criminal proceedings; suspension of proceedings awaiting determination of criminal fraud proceedings.—On February 3, 1978 the court entered the following order:

David V. Anthony, attorney of record, for plaintiff. *Gregory A. Smith, Paul C. Fuener, Pettit, Evers & Martin*, and *Robert E. Davis*, of counsel.

Thomas W. Petersen, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant. *James F. Merow, J. Roger Edgar* and *Robert L. Ashbaugh*, of counsel.

Before DAVIS, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

"This case comes before the court on defendant's request filed December 30, 1977, for prompt review of the trial judge's order of December 20, 1977, denying defendant's motion to suspend proceedings in this court pending resolution of a criminal prosecution of plaintiff for the same conduct. Trial Judge Spector has certified the matter for prompt review under Rule 53(c)(2)(i).

"Defendant's dispute with plaintiff, Litton Systems, Inc., arose from a contract between the Navy and Litton for the construction of three nuclear attack submarines. Litton submitted to the Navy a claim for the portion of cost increases it represented to be attributable to government-caused delays and disruptions during construction. This claim was first presented to the Navy's contracting officer and then appealed to the Armed Services Board of Contract Appeals (ASBCA) which, in April 1976, awarded about $16 million of Litton's $30 million claim. The parties subsequently agreed not to move for reconsideration of the Board's decision. A fraud investigation of Litton had begun prior to the trial before the ASBCA, but it was not until after the Board's decision that the third grand jury (impanelled to determine whether Litton or its corporate officers had committed fraud in the presentation and justification of Litton's claim to the Navy) returned an indictment. The indictment for violation of 18 U.S.C. § 287

(1970), prohibiting submission of a false claim upon the Government, was returned on April 6, 1977 against the Litton company only. Litton then filed suit here on the same day to obtain payment of the amount awarded by the ASBCA one year earlier. The criminal indictment was, however, dismissed by the District Court before trial because of alleged prosecutorial misconduct. The District Court found that the Government had at least impliedly threatened to indict plaintiff criminally if it did not agree to a retrial before the ASBCA of Litton's claim for cost reimbursement (with each side permitted access to the grand jury material). This asserted prosecutorial misconduct was held to justify dismissal of the indictment against Litton. Appeal has been taken to the Fourth Circuit and is now awaiting oral argument as to whether the District Court had evidence sufficient to conclude that the prosecutor's motives were improper, and, if so, whether dismissal of the indictment was the appropriate sanction.

"In the civil proceeding now before us, the Government has relied upon the criminal charges before the District Court in asserting, on information and belief, affirmative defenses, a counterclaim and a special plea in fraud. Litton's claim to the Navy is alleged to be false, and fraud in the proof, statement or allowance of its claim against the United States is alleged to have been practiced—all in violation of 31 U.S.C. §§ 231–235 (1970), 28 U.S.C. § 2514 (1970). The Government's motion to suspend this proceeding pending resolution of the criminal charges was denied by the trial judge primarily because of the long and indeterminate suspension being requested. We find, however, that a stay of the proceeding until the Fourth Circuit has decided the Government's appeal is warranted in the circumstances.

"It seems clear that in the resolution of this suit the court will have to determine whether Litton's claim was false and fraudulent and that this determination will require a great deal of overlap of witnesses and other evidence with the criminal prosecution if it is revived by the Fourth Circuit. The possible pendency of parallel civil and criminal proceedings involving at least many of the same matters cautions us to try to be sure that the broader

discovery permissible in civil proceedings is not unnecessarily used to compromise parallel criminal proceedings. *Peden v. United States*, 206 Ct. Cl. 329, 339, 512 F.2d 1099, 1104 (1975). Here, the Government alleges that Litton's discovery in the civil proceeding attempts to depose witnesses and to compel them to produce documents in their personal possession in order to obtain evidence that would not be available to Litton in the criminal proceeding prior to trial. It is further alleged that the depositions will be one-sided in that Litton already has access to some grand jury evidence and will be able artfully to impeach government witnesses while the defendant, lacking such information, will be unable to rehabilitate or refresh the recollections of the deponents. That Litton's attempted civil discovery may be due to the way in which fraud has been raised in the Government's answer, as plaintiff claims, does not alleviate the harm that may conceivably be caused by the discovery.

"We need not now decide whether these considerations would require suspension of the civil proceedings until the very end of the potential criminal prosecution. It is sufficient for the moment that we wait for the ruling of the Fourth Circuit (we understand that the appeal is to be argued shortly). As a matter of comity and for the pragmatic benefits that may accrue from a clarification of the issues by that court's decision, we will stay these proceedings until the appeal has been decided. At that time, at the request of either party the equities can again be balanced to determine whether the Government has proven that a further stay is merited. *Landis v. North American Co.*, 299 U.S. 248, 254–55 (1936); *Campbell v. Eastland*, 307 F.2d 478 (5th Cir. 1962), *cert. denied*, 371 U.S. 955 (1963). Granting a stay at this time pending resolution of any additional appeals or efforts to review seems to us to be overly broad. See *Landis* at 257; *Dellinger v. Mitchell*, 442 F.2d 782, 785–87 (D.C. Cir. 1970); *McSurely v. McClellan*, 426 F.2d 664, 671–72 (D.C. Cir. 1970).

"As noted above, our decision at this time does not intimate the relative weight we give to a live criminal proceeding vis-a-vis a parallel civil proceeding. We merely find the decision to grant or deny a stay will be more easily

resolvable, and without undue prejudice to plaintiff, by waiting until the possible pendency of a criminal trial is more clearly determined and the parties' rights regarding access to information from the grand jury investigation more easily resolved. This will be possible following decision by the Fourth Circuit. In consideration of the trial judge's order, and briefs of the parties, and without oral argument,

"IT IS ORDERED AND CONCLUDED that defendant's request for prompt review is granted, that the trial judge's order is vacated, and that defendant's request for a stay of proceedings is granted until the Fourth Circuit has rendered its decision on the parallel criminal matter now before it."

No. 321-72. FEBRUARY 9, 1978

James F. Sexton

Judgments; former adjudication; res judicata; claim of wrongful discharge.—On February 9, 1978 the court entered the following order:

James F. Sexton, Pro se.

Alan L. Ferber, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, NICHOLS and KASHIWA, *Judges.*

"This wrongful discharge suit is before the court on defendant's motion for summary judgment and plaintiff's opposition thereto and plaintiff's motion for leave to amend his petition and defendant's opposition thereto. After careful consideration of the briefs, we grant defendant's motion for summary judgment and deny plaintiff's motion for leave to amend his petition.

"The facts of this case are set forth in detail in *Sexton* v. *Kennedy,* 523 F. 2d 1311 (6th Cir. 1975), and need no further elaboration here. Plaintiff originally brought this suit in the federal district court for the Northern District of Ohio. He subsequently filed a protective suit in the Court of Claims but proceedings here were suspended pending the

outcome of the federal district court action. The federal district court suit was concluded when the court granted defendant's motion for summary judgment. *Sexton* v. *Kennedy*, No. C70–883 (July 3, 1974). Plaintiff appealed that decision to the Sixth Circuit Court on the same grounds that he is urging here (i.e., that the administrative record before the district court was incomplete for 46 documents were missing—two of which plaintiff contends are highly relevant). The Sixth Circuit, after reviewing the record and the documents, affirmed the district court. *Sexton* v. *Kennedy, supra.* Plaintiff sought Supreme Court review of the Sixth Circuit's decision, but certiorari was denied, 425 U. S. 973 (1976).

"Defendant's motion for summary judgment contends that under the doctrine of res judicata the federal district court decision bars further consideration of plaintiff's suit in this court. Plaintiff does not agree. We hold that plaintiff's suit is barred by the doctrine of res judicata. Even if there should be a difference in the standard of review followed by this court and the Sixth Circuit Court of Appeals, *see Baum* v. *Zuckert*, 342 F. 2d 145 (6th Cir. 1965), *Roskos* v. *United States*, 213 Ct. Cl. 34, 549 F. 2d 1386 (1977), this does not affect the doctrine of res judicata. Plaintiff chose the forum in which to bring his case and his claim and was given consideration plus full judicial review. He cannot now move to another forum, this court, and relitigate his claim simply because he feels this court may be more sympathetic because it has adopted a different standard of review than the forum in which the first proceeding occurred. Therefore,

"IT IS ORDERED that defendant's motion for summary judgment be and hereby is granted. Further, it is ordered that plaintiff's motion for leave to amend his petition be denied and the petition be dismissed."

Plaintiff's suggestion for rehearing *en banc* and motion for rehearing were denied April 27, 1978.

No. 87-76. FEBRUARY 9, 1978

Bernard Leefer

Civilian pay; reduction in force; reassignment; absence of evidence of arbitrary or capricious agency action.—On February 9, 1978 the court entered the following order:

Joel P. Bennett, attorney of record, for plaintiff.

Susan M. Linden, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, *Judge*, Presiding, KASHIWA, and KUNZIG, *Judges*.

"This civilian pay case is before the court on the parties' cross-motions for summary judgment and defendant's motion to strike certain of plaintiff's materials. Plaintiff (Leefer) alleges arbitrary and capricious behavior on the part of defendant in carrying out a reduction-in-force (RIF) which resulted in plaintiff's accepting a position at a lower grade (albeit the same salary). He further alleges that the intent of the agency was 'to demean' him, 'to frustrate' him, and to 'prepare him for further shocks.' Defendant, on the other hand, argues that the reduction-in-force was a discretionary action which was not taken in an arbitrary or capricious manner and which was, therefore, valid. We agree with defendant.

"Plaintiff, a non-veteran employee of the National Aeronautics and Space Administration (NASA) alleges that he was transferred from Washington, D.C. to Cleveland, Ohio in 1971, and given 58 days to report, despite his protestations that (1) he did not want to go, and (2) he needed more time. He further alleges that, when he got to Cleveland, he was given only 'run-of-the-mill' assignments and was forced to share an office; he claims these actions were not in keeping with his status as a GS–15, step 7. He finally alleges that, on November 23, 1973, he accepted a reduction-in-grade to GS–14 (with two years' pay retention) rather than be discharged through a RIF.

"Plaintiff appealed his reduction-in-grade administratively to the Appeals Examining Office (AEO) and the Board of Appeals and Review (now the Appeals Review Board—ARB), both of which rendered decisions adverse to

plaintiff. Leefer now appeals these decisions to this court, alleging that the succession of agency actions and the Board's decisions were arbitrary, capricious, and abuses of discretion.

"This court agrees with defendant that the course of agency conduct alleged by the plaintiff does not constitute arbitrary and capricious behavior. There is a strong presumption that officials act in good faith, *Grover* v. *United States*, 200 Ct.Cl. 337, 344 (1973), and plaintiff has not overcome this presumption. Transfer to Cleveland may not have been in accordance with plaintiff's desires, but it is hardly *prima facie* evidence of arbitrary and capricious behavior. Somebody has to go to Cleveland. *See, e.g., Comberiate* v. *United States*, 203 Ct.Cl. 285 (1973). Similarly, plaintiff has not convinced us that the subsequent actions by the agency were arbitrary, capricious or abuses of agency discretion.

"In reaching this conclusion, we have not considered those materials put forward by plaintiff in this court which were not in the administrative record. While plaintiff is correct concerning the standard of *de novo* review followed by this court, we have steadfastly refused to consider evidence which may have been withheld by plaintiff at lower levels of the process in hopes of overwhelming the defendant with new evidence here. *See, e.g., Cohen* v. *United States*, 212 Ct.Cl. 568 (1977). Plaintiff has made no showing that his newly submitted evidence was in any way newly discovered or unavailable to him at the time of his administrative appeals.

"For the above reasons, we agree with the defendant that plaintiff, on the submissions properly before this court, has failed to prove any action by the defendant which was arbitrary or capricious or would have constituted an abuse of discretion.

"IT IS THEREFORE ORDERED, upon consideration of the briefs and exhibits of the parties, and after oral argument, that defendant's motion for summary judgment and motion to strike certain of plaintiff's exhibits are granted. Plaintiff's cross-motion for summary judgment is denied, and plaintiff's petition is dismissed."

No. 336-76. FEBRUARY 9, 1978

John C. Barrier and
Laverne Barrier

Pleading and practice; motion to suspend; reference of procedural motions; prompt review by court; standard of review.—On February 9, 1978 the court entered the following order:

Robert E. Kovacevich, attorney of record, for plaintiff. *Richard P. Algeo* and *Kovacevich & Algeo*, of counsel.

James L. Malone III, with whom was *Assistant Attorney General M. Carr Ferguson*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This tax refund case is before the court on the plaintiffs' request for prompt review of the trial judge's November 30, 1977, order suspending further proceedings until March 1, 1978. The request for review is pursuant to Rule 53(c)(2)(ii) since the trial judge refused to certify the issue for our prompt review. After consideration of the briefs and without oral argument, we deny the request for prompt review.

"Plaintiffs' petition claiming a refund for their 1972 taxable year was filed August 12, 1976. Defendant immediately moved for suspension of proceedings on the grounds that a special agent of the Internal Revenue Service was investigating plaintiffs' 1972, 1973, and 1974 tax returns. Plaintiffs did not oppose the original motion to suspend which was granted suspending proceedings until June 1, 1977. Since then defendant has been granted a second suspension of proceedings and the present dispute involves defendant's third request for a suspension of proceedings until March 1, 1978. The trial judge granted the third suspension, but with the warning that further suspensions would be allowed only on a showing of extraordinary circumstances.

"Our standard of review under Rule 53(c)(2)(ii) is whether 'further proceedings pursuant to the said order would irreparably injure the complaining party or occasion a manifest waste of the resources of the court or the

parties.' We do not believe plaintiffs have met this standard. They will be paid interest at the statutory rate for the delay caused by the suspensions should they ultimately prevail. The sole harm plaintiffs will incur due to the further suspension of proceedings is delay in the ultimate resolution of their refund claim. Delay alone is not sufficient grounds for us to grant prompt review. Rule 53(c)(2)(ii). In fact, if we granted plaintiffs' request for prompt review in this case, the effect may well be to waste the resources of the court and the parties. The reason is if this court proceeded to judgment for plaintiffs on the refund claim and subsequently the special agent produced evidence of fraud on the part of the taxpayers, our judgment might be void because of the fraud, *Commissioner* v. *Sunnen*, 333 U. S. 591, 597 (1948), or be vacated upon rehearing, 28 U.S.C. § 2514 (1970). Accordingly,

"IT IS ORDERED that plaintiffs' request for prompt review of the trial judge's November 30, 1977, order suspending further proceedings in this suit until March 1, 1978, be and hereby is denied."

No. 311-77. FEBRUARY 9, 1978

Isabel A. McGowan

Income tax; claim for refund; retirement income credit, failure to claim; audit not notice of entitlement to credit.—On February 9, 1978 the court entered the following order:

Isabel A.McGowan, Pro se.

C. Patrick Derdenger with whom was *Assistant Attor-General M. Carr Ferguson* for defendant. *Theodore D. Peyser,* of counsel.

Before DAVIS, *Judge,* Presiding, NICHOLS and KASHIWA, *Judges.*

"This case is before this court on defendant's motion for summary judgment, to which plaintiff has filed no opposition. Plaintiff failed to claim a retirement income credit, she says, for which she was eligible, in her 1971, 1972, 1973, 1974, and 1975 income tax returns. The Internal Revenue Service audited her 1973 return and should have

caught this error, but failed to do so, she says. Defendant relies on section 6511(a), Internal Revenue Code of 1954, which requires a claim for refund within three years of the date the return was filed, or two years of payment, and defendant says plaintiff's claims on February 16, 1977, met neither of these deadlines as to 1971 and 1972. As to years 1973, 1974, and 1975, defendant says the refunds have been paid.

"Since plaintiff fails to show any refund claim earlier than the one defendant acknowledges having received, and since the mere making of an audit cannot be deemed notice of entitlement to retirement credit, which plaintiff admits she did not claim, plaintiff cannot recover for 1971 and 1972. She does not refute the sworn evidence that the 1973, 1974, and 1975 refunds claimed have been paid, but admits in a letter to defendant's counsel that no issue remains for adjudication as to those years. Accordingly, upon consideration of the motion and the evidence submitted in support thereto,

"IT IS ORDERED that the petition is dismissed."

No. 425–77. FEBRUARY 9, 1978

Kenneth Calloway and
William Calloway

Unjust conviction and imprisonment; sufficiency of petition; Certificate of Innocence.—On February 9, 1978 the court entered the following order:

Jesse L. Leeds, attorney of record, for plaintiff.

Sandra P. Spooner, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This unjust conviction and imprisonment suit is before the court on defendant's motion to dismiss for failure to state a claim within the jurisdiction of the court. After consideration of the defendant's motion and brief in support thereof (plaintiffs filed no opposition brief) and

without oral argument, we grant defendant's motion to dismiss.

"Plaintiffs were imprisoned in November 1974 on a charge of bank robbery. On March 19, 1975, they were found guilty by jury verdict. Plaintiffs appealed that conviction to the Tenth Circuit Court of Appeals and were granted a new trial. They were acquitted in the second jury trial. Plaintiffs each are now seeking $5,000 in damages pursuant to 28 U.S.C. § 1495 (1970) and 28 U.S.C. § 2513 (1970).

"For a petition to state a claim for unjust conviction and imprisonment within the jurisdiction of this court, it must allege the elements set forth in 28 U.S.C. § 2513 (1970). *Vincin* v. *United States*, 199 Ct. Cl. 762, 766, 468 F. 2d 930, 933 (1972). Further, a petition 'should not be dismissed for insufficiency unless it appears to a certainty that plaintiff is entitled to no relief under any state of facts which could be proved in support of the claim.' 2A MOORE'S FEDERAL PRACTICE ¶ 12.08, at 2274 (2d ed.). The pertinent portion of section 2513 reads:

> (a) Any person suing under section 1495 of this title must allege and prove that:
>
> (1) His conviction has been reversed or set aside on the ground that he is not guilty of the offense of which he was convicted, or on new trial or rehearing he was found not guilty of such offense, as appears from the record or certificate of the court setting aside or reversing such conviction, or that he has been pardoned upon the stated ground of innocence and unjust conviction and
>
> (2) He did not commit any of the acts charged or his acts, deeds, or omissions in connection with such charge constituted no offense against the United States, or any State, Territory or the District of Columbia, and he did not by misconduct or neglect cause or bring about his own prosecution.
>
> (b) Proof of the requisite facts shall be by a certificate of the court or pardon wherein such facts are alleged to appear, and other evidence thereof shall not be received.

"Plaintiffs' petition fails to allege that the record or certificate of the court stated that they were found

innocent of the charges against them. However, there is a certificate of innocence in the record which reads:

> I, the undersigned Judge of the U. S. District Court, having been the Trial Judge in the above styled and numbered matter, and having instructed and submitted said cause of action to a jury, and the jury having returned a verdict of Not Guilty therein;
>
> NOW, THEREFORE, on the basis of, and by reason of the verdict of the said jurors, I herewith enter this Certificate of Innocence on behalf of the said William Calloway and Kenneth Calloway, to be made a part of the record herein and filed in said cause.

and, therefore, can be construed as satisfying the requirements of section 2513(a)(1). Still, plaintiffs' petition is fatally defective because the certificate of innocence by the federal district judge does not contain statements required by section 2513(a)(2). Without such statements in the certificate of innocence, plaintiffs cannot prove any claim within the jurisdiction of this court. 28 U.S.C. § 2513(b) (1970). Therefore,

"IT IS ORDERED that defendant's motion to dismiss be and hereby is granted and the plaintiffs' petition is dismissed."

No. 436-77. FEBRUARY 9, 1978

Etowah Manufacturing Co., Inc.

Court of Claims jurisdiction; declaratory relief; absence of demand for refund in tax petition.—On February 9, 1978 the court entered the following order:

J. Richard Carr, attorney of record, for plaintiff.

Marc Levey, with whom was *Assistant Attorney General M. Carr Ferguson,* for defendant.

Before DAVIS, *Judge,* Presiding, NICHOLS and KASHIWA, *Judges.*

"Taxpayer's petition asks for an income tax refund in the sum of $2,415.44 for its taxable year 1974, and for taxable year 1973 asks, without claiming any refund for that year, that it be held entitled to additional deductions in the amount of $5,483.20. Defendant has moved to dismiss the

claim for 1973 because, with respect to that year, taxpayer seeks no monetary relief at all but only a declaratory judgment or advisory opinion.[1] Taxpayer has failed to respond to this motion.

"Defendant is correct. With a few exceptions not relevant here, this court has no power to give declaratory relief; and, as an Article III tribunal, it has no constitutional authority to grant an advisory opinion. *United States v. Testan*, 424 U.S. 392 (1976); *United States v. King*, 395 U.S. 1 (1969). The petition apparently seeks to increase taxpayer's net operating loss for 1973 through increasing the deductions for that year, but no refund demand for 1973, or for a taxable year (if any) to which such an increased loss could and would be carried, is stated in the petition.

"IT IS THEREFORE ORDERED AND CONCLUDED, without oral argument, that defendant's partial motion to dismiss is granted and the petition is dismissed with respect to the taxable year 1973."

No. 496-76. FEBRUARY 9, 1978

Willie Jackson

Military pay; correction of military records; undesirable discharge; limitation of actions; res judicata; laches.—On February 9, 1978 the court entered the following order:

Brice A. Tondre, attorney of record, for plaintiff.

Lynn J. Bush, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"Plaintiff, then a private, was discharged from the Air Force for unfitness in February 1948, with an undesirable discharge, after proceedings before two Boards of Officers. Claiming that those Boards acted arbitrarily and without proper procedures in characterizing his discharge as undesirable, plaintiff brought a suit in the District Court for the District of Columbia which appears to have

[1] Defendant has not moved with respect to the claim for 1974.

been decided adversely to him on the merits. *Jackson v. Secretary of U.S. Air Force*, D.D.C. Civil Action No. 83–71, order of April 30, 1971.[1] Plaintiff's applications for relief were also denied by the Air Force Board for Correction of Military Records in December 1957 and by the Air Force Discharge Review Board in September 1961. Finally, after another application, in 1977 the Air Force Discharge Review Board, acting 'under current policy and clemency', upgraded his discharge to honorable while at the same time confirming the propriety of the type of discharge awarded him in 1948.

"Asserting that the Discharge Review Board was required to set aside the 1948 discharge, plaintiff, without specifying the sums owing, sues here for monetary relief which would be due him if his 1948 undesirable discharge were overturned. Defendant has moved for summary judgment on the grounds of limitations, laches, and res judicata/collateral estoppel. We consider each of these defenses to be dispositive against plaintiff.

"In attacking the refusal of the Discharge Review Board to overturn the 1948 proceedings and discharge,[2] plaintiff raises for the third time in a federal court the very same challenges to his 1948 discharge. At least in the 1971 District of Columbia action referred to *supra*, the court rejected those challenges on their merits. By settled law this bars the current attack under the doctrine of former adjudication since there is no adequate reason for us to reconsider the District Court's decision. Nothing in the Discharge Review Board's recent action casts any doubt on that ruling.

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[1] An earlier suit in the Southern District of Texas, raising the same issues, seems to have been dismissed on jurisdictional grounds. *Jackson v. United States*, S.D. Tex., Civil Action No. 10186, order of Nov. 26, 1956. A later suit on the same claim in the same federal court was dismissed on the ground of *res judicata* and the bar of limitations. *Jackson v. Secretary of the Air Force*, S.D. Tex., Civil Action No. 75–H–1564, order of Sept. 9, 1976.

[2] In 1977 the Discharge Review Board declared (*inter alia*):

'The Board finds on the evidence of record that the administrative discharge board and process were equitable and proper at that time. Based on the totality of the record the Board finds that applicant [plaintiff] was not a suitable candidate for rehabilitation.'

The Board also found that the plaintiff's discharge was 'equitable and proper.'

"On limitations, the plaintiff recognizes that the six-year statute (28 U.S.C. § 2501) would normally have long since run on a 1948 discharge (see, *e.g., Eurell v. United States, ante* at 273, 566 F.2d 1146 (1977), but contends that the 'half-a-loaf' doctrine announced, for example, in *DeBow v. United States,* 193 Ct. Cl. 499, 434 F.2d 1333 (1970), *cert. denied,* 404 U.S. 846 (1971), permits him to found a claim on the allegedly incorrect aspect of the Review Board's favorable determination in 1977. But it is quite clear that the 1977 Board's upgrading of plaintiff's discharge was granted as a matter of 'current policy and clemency,' and that its explicit confirmation of the correctness of the 1948 discharge as of 1948 was separate and not at all connected with that upgrading. The 'half-a-loaf' doctrine applies only where the unfavorable aspects of the administrative decision cannot properly be separated from the favorable ones; the objective is to prevent the board from stopping short of giving the full relief (if requested by the claimant) the law demands for the determination the board itself makes. See *Eurell v. United States, supra.* Here, the upgrading as a matter of 'current [1977] policy and clemency' would not call for any consideration of the character of the discharge given in 1948. A grant of clemency in 1977 is quite distinct from a determination of the legal merits of the 1948 discharge. These were two independent matters which the Discharge Review Board happened to include in one action; if two separate determinations had been made, plaintiff would clearly have had no right to judicial review, at this late date, of the refusal to overturn the type of discharge given in 1948.[3]

"For the same reasons the defense of laches is also valid. Twenty-nine years have passed since his discharge, and it would be most difficult for the Government to defend discharge proceedings which took place in 1948. That is prejudice enough. See *Eurell v. United States, supra.*

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[3] Plaintiff attacks as unwarranted the reasons the Board gave for upgrading his discharge in 1977 but obviously he has no standing to upset that favorable administrative determination. Nor does this attack create a link, as plaintiff obviously hopes to persuade us, with the unfavorable administrative decision to confirm the 1948 discharge when given.

"IT IS THEREFORE ORDERED AND CONCLUDED that defendant's motion for summary judgment is granted and the petition is dismissed."

No. 501–77. FEBRUARY 9, 1978

Jerry Dawkins

Court of Claims jurisdiction; keeper of the Nation's conscience.—On February 9, 1978 the court entered the following order:

Jerry Dawkins, Pro se.

Richard J. Webber, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, NICHOLS and KASHIWA, *Judges.*

"This case is before the court on defendant's motion to dismiss. Plaintiff in response moves for judgment on the pleadings. The plaintiff has a problem with his employer, involving retroactive seniority, the nature of which is otherwise not clear. He apparently wants this court to overrule a decision of the United States Supreme Court, its number 76–1589, styled *Jerry Dawkins, petitioner* v. *Nabisco, Inc. and Bakery and Confectionary Union Local No. 42, denying certiorari,* 433 U.S. 910 (1977), opinion below at 549 F.2d 396 (1977). He grounds our jurisdiction on the assertion that this court is known as the 'keeper of the nation's conscience.'

"The correct quote is, that this court 'holds and speaks a nation's conscience.' It is found in 48 Ct. Cl. XXV (Feb. 11, 1913) a tribute by S.S. Burdett, Esquire to Chief Justice Peelle of this court, on the occasion of his retirement. It is not, and was not meant to be a safe guide to the jurisdiction of this court. That must be found in statutes and court decisions which often speak in a less expansive and generous spirit. No statute can be found which authorizes us to review and overrule decisions of the U. S. Supreme Court on grounds of conscience or any other. Even were the Supreme Court not involved, we could not make an award on the mere ground, without more, that it was owing in

conscience. Plaintiff has, therefore, failed to allege any cause of action within the jurisdiction of this court, and accordingly, upon consideration of defendant's motion, and plaintiff's opposition thereto and cross motion, IT IS ORDERED that plaintiff's motion for judgment on the pleadings is denied, and the petition is dismissed."

No. 414-75. FEBRUARY 17, 1978 AND APRIL 4, 1978

A & H Cleaners, Inc.

Contracts; breach; Government obligation to contractor; timeliness of matters raised in motion for rehearing.—On February 17, 1978 the court entered the following order:

C. C. Malone, Jr., and *T. Mdodana Ringer, Jr.*, for plaintiff. *C. C. Malone, Jr.*, attorney of record. *Pearson, Malone, Johnson, Dejarmon, and Spaulding*, of counsel.

Donnie Hoover, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, *Judge*, Presiding, KASHIWA, and KUNZIG, *Judges*.

"This contract case is before the court on plaintiff's motion for summary judgment and defendant's cross-motion. Plaintiff (A & H Cleaners, Inc.) alleges that its concession contract with the Army and Air Force Exchange Service (AAFES or Post Exchange) granted it the exclusive privilege of providing certain laundry and dry cleaning services to residents of family housing in 'Area C' of Fort Bragg, North Carolina. For the reasons that follow, we agree with defendant that, even assuming this to be an exclusive contract, there has simply been no breach.

"The facts in this case are stipulated. Plaintiff A & H Cleaners is a small business which has provided a laundry service on Fort Bragg since 1966. In 1974, AAFES awarded plaintiff a concession contract, effective July 1, 1974, to provide laundry services including pick-up and delivery to family housing in 'Area C' of Fort Bragg. Plaintiff soon encountered problems. As early as October 1974, plaintiff advised AAFES that others (non-concessionaires) were sol-

iciting customers in the family housing area. AAFES, in turn, notified the Post Commander of these unauthorized activities being conducted by the non-concessionaires and asked the Post Command to help stop those practices. Difficulties with unauthorized competitors continued, as did the correspondence among plaintiff and AAFES and the Post Command. By letter of March 19, 1975, the Post Command outlined to plaintiff the steps that had been taken on plaintiff's behalf, informed plaintiff that the situation was being monitored, and proposed a meeting in 30 days to review the matter. No such meeting was held because, on April 14, plaintiff requested termination of the contract with respect to pick-up and delivery services in the family housing section of Area C and, on April 25, that portion of the contract was terminated.

"Plaintiff argues that it had an exclusive contract and that defendant's failure to keep unauthorized competitors out of Area C constitutes a breach of the contract. In response, defendant contends that, far from breaching the contract, the AAFES (and the Post Commander) took all actions reasonably within their power to assist plaintiff.[1]

"Assuming *arguendo* that this was an exclusive contract, the stipulated facts speak for themselves on the decisive question whether there was a breach. No other party to the contract ever did anything affirmatively to lessen plaintiff's enjoyment of its franchise. The most that can be said is that AAFES and the Post Commander (assuming the Commander to be bound by the contract to some extent) did not do enough successfully to prohibit various strangers to the contract from interfering with plaintiff. We find, however, on the facts before us, that defendant took good faith steps to help get the non-concessionaires out of the family housing area.

"Though the fact that Fort Bragg is an 'open post' (meaning that there are no control gates at the entry points and vehicles can move freely in and out of the unfenced Post) created constraints on the Post Command-

[1] Defendant takes vigorous issue with plaintiff on several other points,(e.g., defendant denies that the contract was, in fact, exclusive). Because we agree with defendant that there was, in any event, no breach, we do not consider the other theories advanced by the defendant.

er's ability to control visitors, the Post Command did take action. The Post Command sent letters to all local laundry firms advising them that solicitation is prohibited. It also issued flyers to residents of the housing area and dispatched notice through the Post news media to the effect that unauthorized firms had been soliciting on Post. These actions more than rebut plaintiff's claim that the contract was breached.

"We feel that plaintiff's strongest point is its argument that the Military Police (MP), Provost Marshal and the Post Command were not enforcing Post regulations restricting the activities of non-concessionaires as rigorously as in the past. But even accepting, as we must, plaintiff's uncontroverted affidavit of Charles Allen (a former affiliate of A & H Cleaners) that the enforcement practices changed after plaintiff was awarded its contract, we still see no basis for saying that defendant breached. Again, assuming that the contract was exclusive (and that the MP and Base Commander as well as the AAFES had certain obligations under the contract), this court would be hard put to tell the Post Commander, in effect, how to run his command. We can assume that, in managing a military installation the size of a small town, the Post Commander is, generally, the appropriate judge of how best to allocate his resources, including the Military Police. Though we may sympathize with plaintiff's predicament, we simply cannot find any breach and, thus, cannot award plaintiff the remedy it seeks.

"IT IS THEREFORE ORDERED, upon consideration of the briefs and exhibits of the parties, and after oral argument, that defendant's cross-motion for summary judgment is granted. Plaintiff's motion for summary judgment is denied, and plaintiff's petition is dismissed."

April 4, 1978

ON PLAINTIFF'S MOTION FOR REHEARING AND OTHER RELIEF
ORDER

"This case comes before the court on plaintiff's motion filed March 2, 1978, for rehearing and other relief pursuant

to Rule 151 with reference to the Order entered herein on February 17, 1978, dismissing plaintiff's petition. Plaintiff, in its motion for rehearing suggests for the first time that the defendant's actions may have been racially motivated. Plaintiff has not previously urged discrimination against minority contractors in support of its claim, and it is now too late. *See General Electric Co.* v. *United States*, 189 Ct. Cl. 116, 416 F.2d 1320 (1969). Upon consideration of plaintiff's motion for rehearing and other relief under Rule 151, together with the response in opposition thereto, without oral argument,

"IT IS ORDERED that plaintiff's said motion for rehearing and other relief be and the same is denied."

No. 444–75. FEBRUARY 17, 1978

Allstates Van Lines Corporation, et al.

Carriers; extra compensation claim; quantum meruit.—On February 17, 1978 the court entered the following order:

Alan F. Wohlstetter, attorney of record for plaintiff. *Denning & Wohlstetter*, of counsel.

John Charles Ranney, with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant.

Before DAVIS, *Judge*, Presiding, KASHIWA, and KUNZIG, *Judges*.

"Plaintiffs' *quantum meruit* claim for compensation for land transportation services rendered in excess of those specified in their contract with defendant is before this court on the parties' stipulated facts. Because we believe that the Government's requiring additional land transportation brings this case within the ambit of our holding[1] in *Trans Ocean Van Service* v. *United States*, 192 Ct.Cl. 75, 426 F.2d 329 (1970), we find that the plaintiffs are entitled to the additional compensation they claim.

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[1] That part of *Trans Ocean* involving plaintiff's entitlement to select entire routing of shipments.

"Plaintiffs agreed to provide land transportation on Code 5[2] household goods shipments moving between points in the Netherlands and Belgium and points in the United States. The ocean transportation was to be accomplished by defendant's Military Sealift Command (MSC), which maintained ocean terminal facilities at six ports in the Netherlands and four ports in Belgium. Rather than utilize any of these ports, however, the defendant required plaintiffs to ship the goods to an MSC terminal in Bremerhaven, Germany, from whence they were shipped to the United States. By making these extended land shipments, plaintiffs incurred an additional cost which the parties have stipulated to be $20,322.64.

"Plaintiffs filed suit in this court to recover these charges, on a *quantum meruit* basis, relying largely upon our decision in the case of *Trans Ocean Van Service* v. *United States*, 192 Ct.Cl. 95, 426 F.2d 329 (1970). In that case we decided, among other things, that where the plaintiff was

> . . . entitled to select the entire routing for the shipment . . . the performance by the plaintiff at the defendant's request of . . . additional land transportation created an implied obligation on the part of the defendant to reimburse the plaintiff for the reasonable value of the extra service. 192 Ct.Cl. at 111, 426 F.2d at 348.

"Defendant responds with an assertion that plaintiff here, unlike the plaintiff in *Trans Ocean*, did not have full responsibility for routing and moving shipments from origin to destination. Defendant further argues that we should follow another portion of the *Trans Ocean* case which held that plaintiff was not entitled to a *quantum meruit* recovery where there was no evidence of any

> . . . contractual provision or understanding pursuant to which the defendant, in connection with a Mode 5 shipment, agreed to utilize . . . the MSTS [now MSC]

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[2] Code 5 service, known as "Door-to-Door Container Surface-Government" involved the prepacking and loading of household goods into special containers owned by plaintiffs, and the transportation of these containers to a port of embarkation. *The parties stipulated that "plaintiffs had full responsibility for routing and moving the shipments from origin to destination."*

port nearest to the destination point. 192 Ct.Cl. at 109–10, 426 F.2d at 347.

"We agree with plaintiffs. Although the shipments here are characterized as 'Code 5 shipments,' the parties have stipulated that 'plaintiffs had full responsibility for routing and moving the shipments from origin to destination.' Since the plaintiffs' quoted rates were for shipments from points in Belgium and the Netherlands, and since the MSC operated facilities in both of those countries, it is understandable that plaintiffs expected to route the shipments through the nearest port, or at least through one of the numerous available ports in the lowlands. The Government's subsequent requirement that the goods be transported overland to a point in Germany prior to ocean shipment renders this situation very similar to the one in *Trans Ocean* where we required the Government to pay additional compensation.

"The Government's assertion that we should deal with these shipments just as the court in *Trans Ocean* dealt with 'Mode 5' shipments is based on the rationale that 'no contractual provision or understanding existed' which would allow plaintiffs to use the nearest port. When this assertion is distilled, it is merely a restatement of defendant's first argument—that plaintiffs did not have responsibility for routing shipments—and must similarly fail as an attempt to contest a stipulated fact. We do not know what evidence the *Trans Ocean* court had before it concerning the Mode 5 shipments, but, based *both* on the stipulation of plaintiffs' full responsibility for routing *and* on the nature and chronology of the agreement involved here, we believe it is fair to state that there existed an 'understanding' that a nearer port would be used.

"If we were to accept defendant's rationale as a basis for our decision, we would be affirming a procedure by which the Government could accept bids for shipments from points in Belgium and then order the carrier to transport the goods overland to Murmansk for shipment without offering additional compensation. Clearly such a procedure would be unacceptable.

"For these reasons, we agree with the plaintiffs that they are entitled to additional compensation in the stipulated

amount of $20,322.64 for the additional overland transportation services required by the Government.

"IT IS HEREBY ORDERED, after consideration of the stipulated facts, briefs, and exhibits of the parties, and after oral argument, that judgment be entered for the plaintiffs in the amount of $20,322.64."

On April 4, 1978 the court denied defendant's motion for rehearing and relief from judgment.

No. 320–76. FEBRUARY 17, 1978

Ronald K. Chedister

Civilian pay; reduction-in-force; validity of RIF; "bumping" rights.—On February 17, 1978 the court entered the following order:

James W. Lawson, attorney of record for plaintiff.

Sandra P. Spooner, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before DAVIS, *Judge,* Presiding, KUNZIG, and BENNETT, *Judges.*

"This case comes before the court on defendant's motion for summary judgment. Upon consideration of defendant's motion, plaintiff's response thereto, defendant's reply, and all supporting affidavits and exhibits, the court finds that there are disputed issues of material fact which preclude disposition of this case by summary judgment.

"IT IS THEREFORE ORDERED that defendant's motion for summary judgment is denied, and that this case is remanded to the Trial Judge with instructions as follows:

"(1) The Trial Judge shall hear evidence and determine the validity of the reduction-in-force (RIF), including plaintiff's allegation that this was no *bona fide* RIF at all but merely a subterfuge by which plaintiff's job was readvertised as a new position and his contention that this new position was awarded to a personal friend of plaintiff's supervisor.[1] Though defendant alleges that plaintiff failed

[1] These allegations, if proved, could support a conclusion that the personnel action here involved bad faith and was therefore arbitrary and capricious. We note that plaintiff's burden, on the merits, is substantial and that plaintiff's ultimate

to exhaust his administrative remedies, it is clear that plaintiff did, in fact, raise the issue of the validity of the RIF in proceedings before the Appeals Examining Office (AEO). The AEO's decision was appealed to the Appeals Review Board (ARB) and the ARB found 'no error on the part of the agency in carrying out the reduction-in-force procedures required by applicable regulations' and sustained the RIF. The ARB has completed its administrative action and has denied plaintiff's request to reopen the matter. The Trial Judge shall report his findings of fact and conclusions of law on the validity of the RIF issue.

"(2) The Trial Judge shall also address the issue whether plaintiff was, in fact, qualified to retreat into the GS–12 position which he claims was arbitrarily and capriciously denied by the ARB's reversal of the AEO's decision. The facts on record, including Mr. Edman's[2] 'advisory opinion' which was introduced for the first time in proceedings before the ARB (and, thus, not considered by the AEO) (*See Rasmussen* v. *United States*, 211 Ct.Cl. 260, 543 F.2d 134 (1976)), are so conclusory in nature as to provide insufficient grounds for us to review at this time. The Trial Judge shall report his findings of fact and conclusions of law on this 'retreat' issue.

"(3) The Trial Judge shall further hear evidence and report his findings of fact and conclusions of law on such other issues deemed relevant."

BENNETT, *Judge*, dissents and would grant defendant's motion for summary judgment.

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likelihood of success is problematic. *See Miatech* v. *United States*, 213 Ct. Cl. 688 (1977); *Wilmot* v. *United States*, 205 Ct.Cl. 666, 682 (1974). But plaintiff has put the question in issue, has supported his allegations with affidavits, and so at least withstands a motion for summary judgment.

[2] Mr. Edman was, during the period in question, Acting Chief, Career Service Division, CSC.

No. 20–77. FEBRUARY 17, 1978

Joseph N. Brant, et al.

Pleading and practice; dismissal; dismissal on rule to show cause as to one plaintiff; counterclaim pending.—On February 17, 1978, the court entered the following order:

Robert A. Johnson, attorney of record for plaintiff.

Robert M. Hollis, with whom was *Assistant Attorney General Barbara Allen Babcock,* for defendant.

Before NICHOLS, *Judge,* Presiding, KASHIWA and KUNZIG, *Judges.*

"In this case the court issued a rule to show cause, returnable at 10:00 A.M., Monday, February 6, 1977. The occasion was that one of the several plaintiffs in the case, Charles H. Pettey, had failed to respond to defendant's interrogatories, and his counsel had failed to respond to a letter of the trial judge calling the matter to his attention. The rule does not affect the other plaintiffs, all of whom have responded. Mr. Pettey failed to appear either personally or by counsel on the date specified in the rule, nor has he communicated otherwise, and the court concludes that he has abandoned his claim.

"However, it is not possible to dismiss the petition so far as it claims on his behalf, because there is a counterclaim to adjudicate and defendant's counsel objects to dismissal. Rule 102(d); *Hageny* v. *United States,* No. 12–73 (order of January 9, 1976).

"IT IS THEREFORE ORDERED that as a matter of law, plaintiff Charles H. Pettey is entitled to recover nothing on his petition, but actual dismissal thereof as to him will be deferred pursuant to Rule 102(d) until final action on the counterclaim."

No. 133–75. FEBRUARY 24, 1978

Solitron Devices, Inc.

Pleading and practice; summary judgment, when appropriate; destruction of evidence; sanctions.—On February 24, 1978, the court entered the following order:

Robert Sheriffs Moss, attorney of record for plaintiff. *Jack B. Friedman, Sullivan, Beauregard, Clarkson, Moss & Brown,* of counsel.

Gerald D. Freed, with whom was *Assistant Attorney General Barbara Allen Babcock. Lenore C. Garon* and *Joan A. Ehrenworth,* of counsel.

Before DAVIS, *Judge,* Presiding, NICHOLS and KASHIWA, *Judges.*

"This case is before the court on defendant's motion for summary judgment, and plaintiff's opposition thereto. There is no cross-motion here, but there is a motion by plaintiff for sanctions which is now pending before the trial judge.

"Plaintiff has petitioned for redetermination of alleged excessive profits as initially determined by the Renegotiation Board, 50 U.S.C. App. § 1218. The fiscal years involved ended February 28, 1967, 1968, 1969, and 1970. Defendant set about an FBI audit, as its custom has long been in such cases. It was discovered that in October 1974 certain records at the Tappan Division of the plaintiff had been destroyed. These included sales journals and sales invoices of the Tappan and other divisions, necessary on audit to establish the allocation of sales between renegotiable and non-renegotiable business. In October 1974, these records had ceased to be of interest to the Internal Revenue Service or the Renegotiation Board. The Board's unilateral orders were issued on January 24, 1975. We may take notice that in October 1974, quite possibly the Board's position was set, the case was already at an impasse, and plaintiff then knew or should have known that in the event of litigation, concern for and interest in its records would pass to another team who would not necessarily be satisfied with what had satisfied the Renegotiation Board. Allegedly, the records were destroyed to permit subleasing of part of plaintiff's plant, but it is admitted that no such sublease was ever made. However, it would be futile to destroy records in anticipation of litigation if they could be reconstructed, and plaintiff says that for all necessary purposes, they could be. We note that in renegotiation, a

broad brush is used. Accuracy to the last penny is not a requisite.

"Defendant says it is now impossible for plaintiff to prove the accuracy of its renegotiable costs and sales data, in a context of mixed renegotiable and non-renegotiable business. Therefore, it cannot sustain the burden of proof as to these matters, assigned to it in *Lykes Bros. Steamship Co.* v. *United States*, 198 Ct. Cl. 312, 459 F.2d 1393 (1972). Resort to secondary evidence is barred, defendant says, because plaintiff cannot meet the precondition in Federal Rule of Evidence 1004(1) that it lost or destroyed the primary evidence other than in bad faith.

"We think that on summary judgment we cannot hold the destruction was in bad faith, suspicious as the circumstances may be. If relevant, this is a fact issue for our trier of fact to resolve. The parties also are wide apart as to the feasibility of reconstructing the lost records from secondary sources. This too is for the trier of fact. Defendant has thus raised issues we must rely on the trial judge to resolve. A motion which takes the case from the Trial Division is inappropriate.

"We are also of the opinion that as a matter of practice in this court, suspected hanky-panky by a party with the evidence can normally be dealt with by sanctions under Rule 76 after proper preliminary steps. This is true even though the misconduct was before suit was brought if the controversy was well under way and suit was to be anticipated. If the misconduct reaches the level of absolute fraud, this may not be true, for the claim (if it is a claim) is then forfeitable. 28 U.S.C. § 2514. If it is short of fraud, the matter would be for the Trial Division under Rule 76, which cannot forfeit a claim, but can construct sanctions to suit the case, which may be well short of forfeiture, or may by their severity be tantamount to forfeiture, subject of course to review by the judges under our rules. Thus, our denial of summary judgment does not remit defendant to going to trial, as it fears, with the effect of the destruction of evidence undetermined and the allocation of renegotiable sales still at issue.

"We note that plaintiff has made a motion for sanctions, for it, too, questions the propriety of its opponent's dealings

with evidence. In view of this, and to save time, instead of denying the motion for summary judgment without prejudice to sanctions, we elect to deem it as itself a motion for sanctions and remand it to the Trial Division for further proceedings. Both motions can then be treated simultaneously as cross-motions, which should make it easier for the trial judge to reach a resolution fair to all, and to get the case moving again.

"IT IS SO ORDERED."

JUDGMENT ORDERS

INSTRUMENT SYSTEMS CORP. AND HAROLD BECK v. THE UNITED STATES

Nos. 338–73 and 339–73

[212 Ct. Cl. 99, 546 F. 2d 357]

On September 22, 1977 the court entered an order, based on stipulated settlement entered into between the parties, providing that in No. 338–73 Dixie Bedding Company, plaintiff's predecessor-in-interest, realized during its fiscal year ending July 31, 1967, excessive profits in the amount of $50,000 from contracts subject to the Renegotiation Act of 1951 and that in No. 339–73, during its fiscal year ending July 31, 1968, it realized excessive profits in the amount of $250,000, said amounts, less appropriate state and federal tax credits, if any, to be paid by plaintiffs to the appropriate agency of the United States Government, with no interest to be levied thereon.

BLUE BELL, INC. v. THE UNITED STATES

No. 603–71

[213 Ct. Cl. 442, 556 F. 2d 1118]

On October 14, 1977 the court entered an order determining that plaintiff realized excessive profits for the year ending October 31, 1967 in the amount of $78,000 plus interest at the rate of $8.547 per day from June 13, 1970 to October 15, 1977.

SCHIAVONE-CHASE CORP., AND THE SCHIAVONE-CHASE CORP., LEHMANN DISTRIBUTORS, WHITING & PIKE, LTD., PTR (A JOINT VENTURE) v. THE UNITED STATES

No. 100–72

[213 Ct. Cl. 539, 553 F. 2d 658]

On November 4, 1977 the court entered judgment for the defendant in the sum of $179,781.12 in full settlement of plaintiffs' claims against defendant and defendant's counterclaims against plaintiffs.

NIAGARA MOHAWK POWER CORPORATION v. THE UNITED STATES

No. 368–72

[214 Ct. Cl. 686, 558 F. 2d 1379]

On November 4, 1977 the court entered judgment for plaintiff in the sum of $242,426.28, together with interest according to law.

GENERAL MOTORS CORPORATION v. THE UNITED STATES

No. 209–75

[213 Ct. Cl. 706]

On November 4, 1977 the court entered judgment for plaintiff in the sum of $11,753.98.

HECTOR CRUZ-CASADO v. THE UNITED STATES

No. 214–75

[213 Ct. Cl. 498, 553 F. 2d 672]

On December 9, 1977 the court entered judgment for plaintiff in the sum of $15,801.77, from which $529.03 is to be paid to the Internal Revenue Service, and the balance is to be paid to plaintiff.

ST. ELIZABETH HOSPITAL v. THE UNITED STATES

No. 347–74

[214 Ct. Cl. 332, 558 F. 2d 8]

On December 16, 1977 the court entered judgment for plaintiff in the sum of $250,699.

TRISTATE DEVELOPERS, INC. v. THE UNITED STATES

No. 439–72

[212 Ct. Cl. 486, 549 F. 2d 190]

On December 16, 1977 the court entered judgment for plaintiff in the sum of $16,775.64, together with interest as provided by law.

APARACOR, INC., FORMERLY QUEEN'S-WAY TO FASHION, INC. v. THE UNITED STATES

No. 139–73

[214 Ct. Cl. 130, 556 F. 2d 1004]

On February 24, 1978 the court entered judgment for plaintiff in the sum of $101,021.92, with interest at the statutory rate.

REPORT OF DECISIONS

OF

THE SUPREME COURT

IN COURT OF CLAIMS CASES

Action was taken by the United States Supreme Court on the parties' petitions for writs of certiorari as follows:

Petitioners	Ct. Cl.	F. 2d	Supreme Court
			DENIED
Juan M. Huerta	212:473	548:343	434 U.S. 828
No. 110–69			Oct. 3, 1977
Emmett E. Norton, et ux.	213:215	551:821	434 U.S. 831
No. 31–75			Oct. 3, 1977
A. Devereau Chesterton, Estate of	213:345	551:278	434 U.S. 835
No. 56–75			Oct. 3, 1977
Kabua Kabua, et al.	212:160	546:381	434 U.S. 821
No. 119–75			Oct. 3, 1977
Curvin J. Trone, Jr., et al.	213:671		434 U.S. 821
No. 135–75			Oct. 3, 1977
Charles L. Meyer	212:537		434 U.S. 817
No. 182–75			Oct. 3, 1977
Helen A. Pryor	212:578		434 U.S. 824
No. 237–75			Oct. 3, 1977
Kalvar Corp.	211:192	543:1298	434 U.S. 830
No. 249–75			Oct. 3, 1977
People of the State of California	213:329	551:843	434 U.S. 857
No. 281–75			Oct. 3, 1977
Gary A. Hendrix	214:50	555:785	434 U.S. 849
No. 306–75			Oct. 3, 1977
Wardell F. Clark	212:590		434 U.S. 839
No. 346–75			Oct. 3, 1977
James G. King, Jr.	214:795		434 U.S. 855
No. 72–77			Oct. 3, 1977
Washington Medical Center, Inc., et al.	211:145	545:116	434 U.S. 902
Nos. 359–72, 333–73, 156–75, 246–75	211:379		Oct. 17, 1977

Petitioners	Ct. Cl.	F. 2d	Supreme Court
			DENIED
Charles R. Groft	214:779		434 U.S. 905
Nos. 193–76 & 396–76			Oct. 17, 1977
Discount Co., Inc.	213:567	554:435	434 U.S. 938
No. 178–75			Nov. 7, 1977
Joseph B. Bergen	213:609	562:1197	434 U.S. 939
No. 356–74			Nov. 7, 1977
Orlin Gentry Cole	214:792		434 U.S. 943
No. 543–76			Nov. 7, 1977
Donald R. Gratehouse	206:288	512:1104	434 U.S. 955
No. 328–73	213:667		Nov. 14, 1977
Ralph M. Koontz	213:762		434 U.S. 984
No. 151–76			Dec. 5, 1977
Sea-Land Service, Inc.	213:555	553:651	434 U.S. 1012
No. 331–72			Jan. 9, 1978
C. Clyde Atkins, et al	214:186	556:1028	434 U.S. 1009
Nos. 41–76, 132–76 & 357–76			Jan. 9, 1978
Stephen Pitcairn	212:168	547:1106	434 U.S. 1051
No. 50328	212:224		Jan. 23, 1978
Robert F. Simmons Constr. Co., et al.	200:748		434 U.S. 1074
No. 213–70			Feb. 21, 1978

ALLEN AARON JACKSON v. THE UNITED STATES

No. 259–76

[213 Ct. Cl. 354, 551 F. 2d 282]

In an opinion reported at 213 Ct. Cl. 354, 551 F. 2d 282 (1977), the court in dismissing the petition held that plaintiff's claim sounds in tort and that the court does not have jurisdiction pursuant to 28 U.S.C. § 1491. Plaintiff seeks to recover damages for alleged breach of a 3–year enlistment contract, asserting that the recruiting officer promised that plaintiff would be allowed to attend an automotive mechanical maintenance school and that he would not be assigned to dangerous combative-type military activities. He was assigned to a tank division for on-the-

job training in the requested mechanical maintenance, and during combat maneuvers a tank ran over him necessitating amputation of the lower half of his body. Plaintiff petitioned the Supreme Court for a writ of certiorari, and during the proceedings the Government admitted for the first time that plaintiff had finished his basic combat training prior to the time of his injuries; the Solicitor General recommended remand of the case for interpretation of DA Form 3286–47–R, Part VI, Sec. I, para. 1(c). On November 14, 1977 the Supreme Court ordered that the judgment of this court be vacated with costs, and that the cause be remanded for further consideration in light of the position asserted by the Solicitor General.

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